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AN ECONOMIC EVALUATION OF THE ALBERTA ESTATE TAX REBATE ACT

by

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The undersigned certify that they have read, and recommend to the Faculty of Graduate Studies for acceptance, a thesis entitled ...AN ECONOMIC EVALUATION OF THE ALBERTA ESTATE TAX REBATE ACT ....

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ABSTRACT

On April 1, 1967 the government of Alberta introduced the Estate Tax Rebate Act. This statute allows for the return of the entire provincial portion of the federal estate tax to those estates, whose owners fulfill the domicile or resident requirements of the Act.

The purpose of this study is to analyze the reasons upon which the introduction of the Act was based, and to evaluate the economic implications of the statute in light of the expectations of the provincial government.

The conclusion of the study is that, since within its frame of reference, only some of the reasons and expectations can be accepted, the government may have had other than economic consideration in mind when it passed The Alberta Estate Tax Rebate Act.

TABLE OF CONTENTS

ACKNOWLEDGEMENTS.. ii

ABSTRACT.. iii

TABLE OF CONTENTS.. iv

LIST OF TABLES.. vi

CHAPTER

I. INTRODUCTION.. 1

II. THE DEVELOPMENT AND USE OF WEALTH TRANSFER TAXATION IN CANADA.................................... 3

Succession Duties

Estate Taxes

The Alberta Estate Tax Rebate Act

III. REASONS FOR ABOLISHING ESTATE TAX LIABILITY........... 16

IV. THE INCIDENCE OF ESTATE TAXES.......................... 20

V. THE EFFECT OF ESTATE TAX REBATE ACT ON SAVINGS........ 27

Reasons for Saving

The Analysis of the Estate Tax Resolution

VI. THE EFFECT OF THE ESTATE TAX REBATE ACT ON INVESTMENT AND MOBILITY OF WEALTH.............. 46

Investment by Individuals

Investment by Privately Owned Businesses

Institutionalized Investment

Mobility of Wealth

VII. THE EFFECT OF THE ESTATE TAX REBATE ACT ON ESTATE LIQUIDITY................................. 68

VIII. THE GENERAL EFFECT OF THE ESTATE TAX REBATE ACT....... 81

IX. SUMMARY AND CONCLUSION................................. 83

APPENDIXES

1. THE CALCULATION OF AGGREGATE TAXABLE
VALUE OF AN ESTATE.................................... 87

2. DEDUCTIONS ALLOWED FROM THE 'TAX OTHERWISE PAYABLE'..... 90

3. THE ALBERTA ESTATE TAX REBATE ACT....................... 91

4. ESTATE TAXES AS A PERCENTAGE OF PROVINCIAL
AND FEDERAL TAX REVENUE................................. 98

SELECTED BIBLIOGRAPHY... 99

LIST OF TABLES

TABLE Page

1. DIRECT NON-GOVERNMENT INVESTMENTS IN ALBERTA FOR 1951-68 PERIOD.................................... 54

2. ALBERTA AFTER-TAX PERSONAL INCOME FOR SELECTED INCOME RANGES................................ 57

3. AMOUNTS OF INCOME FOR INCOME CATEGORIES AND THEIR PROPORTION OF THE TOTAL AFTER-TAX INCOME............. 60

4. AMOUNT OF SAVING AS A PER CENT OF INVESTMENT WITH THE VARIOUS SAVING RATIOS........................ 62

5. THE RELATIVE IMPORTANCE OF EACH TYPE OF ASSET FOR VARIOUS SIZE CLASS OF ESTATES................... 79

CHAPTER I

INTRODUCTION

The purpose of this study is to analyze the reasons for abolishing estate tax liability in Alberta and to evaluate the economic effects expected by the government from its Estate Tax Rebate Act.[1]

The reasons for the Act were given in a resolution passed by the Alberta Legislature on April 15, 1966. These were:

> (1)....the imposition of estate tax is discriminatory in that it constitutes a form of double taxation, and
>
> (2)....millions of dollars are lost to the Canadian economy through individuals establishing domicile outside Canada in jurisdictions where estate taxes are not imposed, and
>
> (3)....the capitalization of pensions and the impact of inflationary trends on the appraisal value of real property are bringing large numbers of estates within the application of estate taxes, frequently creating circumstances which work a financial hardship on the survivors of the deceased.[2]

The analysis of these reasons will be introduced in Chapter III.

The expected economic effects of the Act are:

1. "...the Act should provide an additional incentive to acquisition of wealth."[3]

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[1]See Appendix 3 for the complete text of the Act.

[2]Government of Alberta, Journals of the Legislative Assembly of the Province of Alberta, (Edmonton: L.S. Wall, Queen's Printer, 1966), LXXI, p. 124.

[3]F. G. Wyatt, "The Estate Tax Rebate Act (Alberta) and Its Potential Effect on Real Estate Investment" (paper presented at the meeting of the Canadian Institute of Realtors Edmonton Chapter, Edmonton, Alberta, May 4, 1968), p. 23.

2. The amount of investment and the inability of wealth should be increased by the migration of individuals and business firms to Alberta, by the intention of estates in the province and by increased investment in Alberta's industrial and agricultural development.

3. The Act should also "Prevent liquidation of farms (and) family businesses..."[4]

4. Taxation climate favorable for estate planning is expected to develop.

The foregoing effects are analyzed and evaluated in Chapters V to VIII respectively.

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[4] Ibid., p. 23.

CHAPTER II

THE DEVELOPMENT AND USE OF WEALTH TRANSFER TAXATION IN CANADA

Wealth transfer taxes can be divided into two categories: succession duties and estate taxes.

A. Succession Duties

> A succession duty...is a tax placed on the gratuitous acquisition of property which passes on death of any person by means of a transfer...from one person to another person...Each succession is taxed individually, the rate of tax being ascertained by reference to (1) the total value of the estate (2) the value of the particular succession and (3) the relationship of the beneficiary to the deceased.[1]

In chronological order of implementation, the provincial succession duties are mentioned first.

The prototype legislation was passed in 1892 by the Province of Ontario but was modelled after legislations existing in New York and Pennsylvania States. Property was defined as all real and personal property capable of being bequeathed or transferred upon the death of a person.[2]

> The combined initial and additional rates of today were unknown, there being one tax only based on the aggregate value of the estate and varying with the degree of consanguinity of the beneficiary to the deceased.[3]

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[1]CCH Canadian Limited, Canadian Estate Tax and Succession Duty Guide, (Don Mills, CCH Canadian Limited, 1967), p. 7.

[2]Albert L. Bissonnette, "Canadian Death Duty Legislation 1892-1958", Canadian Bar Review, XXXVI (May, 1958), p. 216.

[3]*Ibid.*, p. 216.

In the same year New Brunswick, Nova Scotia and Quebec introduced succession duties followed in 1894 by Manitoba, British Columbia and Prince Edward Island and in 1905 by Alberta and Saskatchewan. These statutes were based on the expectation that the ruling of the Privy Council[4] was to be upheld if the constitutionality of the above Acts were challenged. Section 92 of the British North America Act states that:

> In each Province the Legislature may exclusively make Laws in relation to Matters coming within the classes of Subject next hereinafter enumerated...
>
> ....
>
> 2. Direct Taxation within the Province in order to the raising of a Revenue for Provincial Purposes.[5]

The Privy Council in the above referred case accepted J. S. Mill's definition of the direct taxes, viz., that.... "a tax which is demanded from the very person who it is intended or desired to pay it"...[6] The Quebec Act, as it was used at the turn of the century, was ruled unconstitutional[7] because the succession duty was the liability of the executor who was indemnified by the beneficiary. This shortcoming was remedied first by the Province of Quebec and later by all provinces by making the person who is taking the property liable. Thus the requirement that the succession duty be a direct tax was satisfied.

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[4]Bank of Toronto v. Lambe (1887) 12 A.C. 575.

[5]The British North America Act, art. VI. sec. 92.

[6]Bissonnette, Canadian Death Duty, p. 217.

[7]Cotton v. The King 1914 A.C. 176.

The direct taxes must fall within the provincial borders as well. The early provincial taxes were based on real properties situated (i.e., having situs) in their respective jurisdiction and transferred to persons domiciled in the respective provinces from individuals with the same legal status. The "domicile" of an individual is a legal concept which was and still is important in the determination of death duty liability. Every person, at law, is domiciled somewhere at any particular time. This usually refers to a country, yet where the country is divided into separate tax jurisdictions, the domicile of any individual has to be more precisely defined. The domicile of origin is acquired at birth. To lose the domicile of origin, a residence must be established in a new jurisdiction with a clear intention of having the newly established residence as a permanent home. The legal requirements to satisfy the courts of the intention, the circumstance and the conduct of the party wishing to acquire a domicile of choice is not going to be discussed here. Suffice it to say that the domicile of origin "...is never lost but remains in abeyance to revive if the domicile of choice is lost."[8]

Situs of the property was and is an equally important consideration in the determination of death duty liability. The real estate property which was situated in a province has never caused problems to the provinces after the beneficiary was made liable for the succession duty wherever the successor was domiciled. The real estate property

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[8] CCH, Canadian Estate Tax..., p. 10.

which had its situs in another province, however, required litigation[9] to determine that taxes on the transmission of the property from a decedent who was domiciled in a particular province to a beneficiary who is also domiciled in the same province is constitutionally sound and not the taxes on the thus situated real estate property per se. The situs regulations of moveable and personal property are complex and more technical in nature and need not be considered here.

The development of provincial succession duties prior to 1941 (when the federal government joined the succession duties field) can be summed up as follows:

1. The provinces can impose death duties as long as the liability rests on the beneficiary and not on the executor.

2. They can impose a tax on any form of property situated in the province, no matter where the decedent or beneficiary is domiciled or resident.[10]

The consequence of the above development was that real estate and personal property was subject to double taxation. This was possible because the property was first taxed by the province in which such a property was situated, and secondly it was taxed by the province in which the "...deceased and the beneficiary were domiciled, by means of the tax on the transmission."[11] There were a series of agreements between the provinces to mitigate the double taxation characteristics of the succession duties. Provinces granted reliefs from death duty liability payable to any individual province if other jurisdiction

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[9] Woodroff v. Attorney-General for Ontario, (1908) A.C. 508.

[10] J. Harvey Perry, Taxation in Canada, (Toronto: University of Toronto Press, 1961), p. 187.

[11] Ibid., p. 188.

levied taxes on the same property. Similar agreements were made between the provinces and some foreign countries as well.[12] Some of these agreements were repealed intermittently, depending on the need for revenues of the particular province, so that a complete elimination of the double taxation on the transfer of savings was not achieved.

The provinces, taking cognizance of the required direct tax nature, the domicile and situs requirement of their succession duty legislations, were alone in this field of taxation until 1941 when the federal government passed the Dominion Succession Duty Act and thereby entered this field as well. The decision was

> ...motivated by the necessity of raising additional revenues for war purposes, but that it was not to be a temporary measure was made clear by the then Minister of Finance, Mr. Ilsley, when introducing the measure. That Canada should enter the field, indeed, that it should occupy the field exclusively, had been one of the recommendations of the Rowell-Sirois Commission Report published the year before.[13]

This Act drew its base upon the right to "succession". According to Bayly, one of the first commentators on the succession duties in Canada:

> The right or privilege tax can perhaps be regarded either as on the right or privilege of the owner of property to transmit it on his death by will, ...to certain persons: or as on the right or privilege of these persons to receive the property.[14]

The property was given a wider definition in the federal Act than in the existing provincial legislation since the interest in and

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[12] Bissonnette, <u>Canadian Death Duty</u>..., pp. 220-221.

[13] <u>Ibid</u>., p. 221.

[14] R. A. Bayly, <u>Succession Duty in Canada</u>, (Toronto: The Carswell Company Limited, 1902), p. 3.

the income from, whether directly or through bequest, was to be included in the property to which the "right" belonged. The "succession" was to include beside the property passing on death, the property transferred in contemplation of death, the gifts _inter vivos_ made within three years prior to the death of the deceased, the gifts _inter vivos_ made more than three years prior to death if such a gift contained provisions by which the donee did not have full power and benefit to the entire exclusion of the donor. The tax rates were composed of (1) the rate which was a function of the size of the total estate and (2) the rate which was based on the size of individual succession of the donee and the degree of consanguinity of the beneficiary to the deceased. The rates were changed in 1946 when the government doubled the tax rate schedule. In the same year legislation was passed by the House of Commons to allow for deductions from the federal tax liability where provincial duties have been paid on the same property. The deductions were either the full amount of provincial duties paid or one-half of the federal duty payable, whichever was less. The federal government had, similarly to the provinces, made agreements with some foreign countries to mitigate the double taxation aspects of its succession duty legislation. In spite of the deductions allowed "...the total tax bill for the average estate was still considerably higher than it had been prior to 1941, when the federal government first entered the succession duty field."[15]

In 1947 all provinces except Ontario and Quebec abandoned their

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[15] Wyatt, "The Estate Tax Rebate Act...," p. 1.

right to collect succession duties in return for a share of duties collected by the federal government. This bilateral agreement between the consenting provinces and the central government was to extend over a five year period with renewable option. The latter was exercised until 1962 when the formal agreements were abandoned, and those provinces which do not levy succession duty agreed to accept 50 *per cent* of the standard estate tax applicable to a particular province for the fiscal year. This latter agreement was incorporated in the Federal-Provincial Fiscal Arrangements Act of 1960-61. This Act was amended in 1964 and the abatement was increased to 75 *per cent* to the consenting provinces.[16] In 1963 British Columbia reintroduced its Succession Duty Act joining Ontario and Quebec.

B. *Estate Taxes*

The second major category of wealth transfer taxes is the estate tax. The estate tax considers the total accumulated wealth, wherever situated, of a deceased person. The Estate Tax Act was passed by the House of Commons on September 6, 1958 and was designed to replace the Succession Duty Act. The new Act came into power on January 1, 1959 and governed the estates of those who died on or after this date. The Succession Duty Act was not repealed, however, and still governs those estates which were left by people who died prior to January 1, 1959.

The characteristic which distinguishes the Estate Tax Act from its federal predecessor most clearly is that the former reaches out to tax the real estate properties of an individual wherever those

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[16] *Ibid.*, p. 2.

properties are situated, whereas the latter confines its scope to the properties having Canadian situs. For the universality nature of the Act to be applied the decedent must be domiciled in Canada. Given this provision, the tax is levied on aggregate taxable value which is the gross estate less debt (i.e., net aggregate value of the estate) less the authorized deductions.[17] The tax rates on Canadian-domiciled estates are progressive. In the case of a foreign-domiciled estate, the Act defines a flat rate of 15 per cent on that part of the estate which is situated in Canada, provided the net value of property with Canadian situs is more than $5,000. After the amount of tax payable on domiciled estates is calculated (by multiplying the aggregate taxable value by the corresponding tax rate) various tax credits can be applied to reduce the federal liability.[18]

The valuation of property under the Act is to be made at the time of death. The value must be the fair market value. For some assets like real estate property, listed common stocks or bonds of publicly owned companies market price is easily available. For other savings like personal property or small private companies, market price may not be readily available, and the executor assessment of the value of these properties must be identical with the assessed value made by the Minister of Finance. There are special regulations to assess the value of gifts *inter vivos*, the debts due to the deceased and annuities.

The executor is responsible, under the Act, for the payment of tax "which is applicable to the property under his control. The tax

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[17]For calculation of aggregate taxable value, see Appendix 1.

[18]The deductions which may be used by an executor against "tax otherwise payable" are delineated in Appendix 2.

is payable by him in his capacity as executor only,..."[19] If the tax is not paid by the successor(s) after the executor has transferred the property to beneficiary(ies) and the executor did not take proper care and diligence to ensure that the tax is paid in full on the properties so transferred, the executor is personally liable. The successor is liable for the estate tax payable for that portion of his succession which is not under control of the executor.

In 1962 the federal government established the Royal Commission on Taxation with Mr. K. LeM. Carter as its chairman. The Commission is usually known as the Carter Commission. Bequests and gifts, if all the recommendations of the Carter Commission were accepted, would be added to the comprehensive tax base which would be formed by adding all the income of a particular family unit together if the bequests and gifts originated from another resident tax unit. As a part of the comprehensive tax base, the bequests and gifts thus obtained would be taxed at ordinary income tax rates. If transfers (either in the form of bequests or gifts) were made within a family unit no tax would be applicable. These are provisions made to prevent abuses "...through marriages undertaken solely for the purpose of reducing taxes on transfers of property..."[20] If transfer of property is made between two or more tax paying units, double taxation could result since the donor unit would be taxable if the fair market value of the transferred property is in excess of the value which was recorded in the previous

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[19]CCH, Canadian Estate Tax..., p. 33.

[20]William M. Carlyle, Gifts, Inheritances and Trusts and the Carter Report, (Don Mills: CCH Canadian Limited, 1967), p. 7.

taxation year _ceteris paribus_, and the donee unit would have to pay taxes on the fair market value of the received transfer. This argument excludes the establishment of Income Adjustment Account by dependent children upon receiving transfers from without their tax unit. Income Adjustment Account is a vehicle for mitigating the tax liability of the family unit in any particular year. The deposits made to this account are interest bearing and any withdrawal made by the donee at any time would be included in the income of the unit for the year in which such a withdrawal is made. Total withdrawal is compulsory when a child, the owner of the account, leaves the family unit.

The federal government on October 22, 1968, proposed an amendment to the Estate Tax Act. This amendment incorporates some of the Carter Commission's recommendations. An interspousal bequest, a transfer of property

> ...to a trustee subject to a trust under which only the spouse of the person has, during the spouse's lifetime, a right of any kind whatsoever to receive, use or enjoy any of the property so settled on a beneficial interest in any of the income from such property.[21]

A creation of an absolute income trust for the benefit of the spouse only, can be all deducted from the aggregate net value of any estate. This group of resolutions is the first major change in the Estate Tax Act. The second major change in the said Act is the integration of gratuitous _inter vivos_ gifts with the properties transferred at death. The Gift Tax Resolution, beside changing the gift tax rates and the exemptions applicable on any particular year to any individual made

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[21] _The Financial Post_, November 2, 1968, p. 10 gave the full text of the Resolution.

the new progressive tax rate schedule to apply to the cumulative total of all future gifts made by the donor. Interspousal gifts or gifts to an absolute trust created for the spouse are exempt. The cumulative nature of the resolution will work in such a way that taxable gifts made by a donor in any particular year will be added to the cumulative sum of such gifts made by the donor in all previous years since October 22, 1968, and the tax payable in the valuation year will be the difference between the tax calculable for the end and the tax calculable for the beginning of the valuation year. The cumulative gift tax rates range from 12 *per cent*, if the gift sum does not exceed $5,000, to 75 *per cent* if the gift sum exceeds $200,000. At the time of death, the cumulative gift tax paid by the deceased upon property passed as gifts which are included in the aggregate net value of the estate, are included in the estate sum. Furthermore, the increment in the cumulative gift sum for the year in which the death occurs and the corresponding gift tax are also included in the estate of the deceased. The proposed tax rate schedule is then applied to deceased person's estate sum or gift sum, as the case may be, provided that the sum is more than $20,000. The tax rates are graduated in such a way that the amounts of taxes collected by the federal government are to remain about the same as they were in previous years in spite of the new exemptions granted.

The Alberta Estate Tax Rebate Act

The Province of Alberta vacated the succession duty field in 1947 and did not concern itself with succession or estate duty legislation until March 30, 1967, when the Alberta Legislature passed the Estate Tax Rebate Act. This Act incorporates some of the recommendations

made to the provincial government by the Public Expenditure and Revenue Committee which was established in 1963, and its Report was published in March of 1966. According to the Federal-Provincial Fiscal Arrangements Act, the federal government rebates 75 per cent of the federal estate tax attributable to: (a) property situated in Alberta and (b) where the deceased is domiciled and the successor is either domiciled or resident in Alberta, any property which is situated outside Canada (as long as the property is other than real property). With respect to this rebate the Committee recommended,

> That, notwithstanding the loss of some revenue, arrangements be made to rebate to the assessed estate all or a major portion of the Province's share of the Federal Estate Tax.[22]

This recommendation was accepted by the provincial government. Thus, on estates for which the death occurred on or after April 1, 1967 and simultaneously fulfilled the eligibility provisions of the said Act, the provincial Administrator of the Rebate Act, 90 days after the assessment is received, and an application for rebate on the estate, issues a written statement advising the executor or successor about the amount of the rebate that he can expect. An estate is eligible for rebate if the deceased at the time of his death was either domiciled in Alberta or "...resided in Alberta for a total of at least 183 days in each of the three (calendar) years immediately preceding his death."[23] Since only the federal government is able to change the law on matters of domicile, situs, and valuation of property for estate

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[22] Wyatt, The Estate Tax Rebate Act..., p. 18.

[23] *Ibid.*, p. 20.

tax purposes, the provincial Rebate Act follows the rulings of the Minister of National Revenue with respect to these matters.

To analyze and evaluate the economic effects of the provincial Estate Tax Rebate Act (henceforth it will be referred to as the Act), it is necessary to stress that the Act operates only under the prevailing federal Estate Tax Act as far as definitions and its jurisdiction is concerned. In the following analysis it will be assumed that the October 22 resolutions of the federal government will be enacted as proposed, and secondly, that no other province in Canada will pass legislation similar to the Act in the near future.

CHAPTER III

REASONS FOR ABOLISHING ESTATE TAX LIABILITY

The first reason upon which the Act is based is that estate taxes are a form of double taxation and consequently are discriminatory in nature. In order to accept this reason without qualifications, it is necessary to agree with the contention which asserts that estates in general are formed from savings which were a part of an income stream of the testator. This income stream was taxed as it was earned and thus, the savings are already taxed before the estate tax is levied on them. When the estate taxes are levied and subsequently paid, this levy constitutes double taxation and is discriminating against those who are thrifty. Even for this argument to be true, it is necessary that the value of the estate equals the sum of the testator's saving over time. This in turn means that the amount of income saved in any particular year is invested (not necessarily in the sense that this word is used in economic theory) either in such a manner that the invested amount does not appreciate nor depreciate over time, or that the investment's yearly appreciation is received by the investor in a form of income, which in turn is taxed in a confiscatory manner.

It is difficult to generalize the fate of any investment, but if it is made in such a way that over time the committed saving appreciates in value, the sum of savings will be less than the amount of the estate at the time of the testator's death. Furthermore, since in Canada the capital gains are not taxed, only the amount of saving

which was obtained, and not consumed, as payment for factor employment can be considered to be taxed twice while being in the same person's possession. If the invested savings yield a yearly income, this is not confiscated by the government, and if the thus received income is reinvested, the value of the estate will be larger than the amount saved by the individual and the argument used in the previous sentence applies. The final possibility, that the invested savings depreciate in value over time and in the limit will become worthless, there would be no estate left upon which to levy a tax. It is possible to have a situation where taxes are applied twice to the same amount of savings, but the value of the estate must be less than or equal to the amount of savings.

There is one other aspect of estate taxation which must be considered with respect to the provincial government's double taxation argument. This is that there are three provinces which levy succession duties on real property which is situated in the respective provinces (these provinces are: Quebec, Ontario and British Columbia). Similarly, their levy reaches out and includes personal property having situs outside their jurisdiction but is transferred to an individual who is domiciled in either of these three provinces. Since, in the federal government's resolution introduced in the House of Commons, there was no special mention of the problems that can arise because of the two separate wealth transfer taxes in existence in Canada, it sill be assumed that the previous reciprocal estate tax credit arrangements are still in operation. Given this assumption, and the new federal Estate Tax Act, what can be said about the taxes levied on an estate whose owner had properties in any of the three succession duty levying

provinces and the Act was not passed in this province?

An estate which has real property situated in either of the three succession duty levying provinces will be paying, beside the estate tax applicable to the whole estate, succession duties as well, according to the argument in the previous paragraph. If the value of the property situated in these provinces is larger than the amount of saving invested into it, the capital gains portion of the value of the estate will be subject to double taxation even after the estate tax credits are taken into account, since the federal tax credit never exceeds 75 per cent of the estate tax payable on properties situated in these provinces (see Appendix 2).

The introduction of the provincial Act will not ameliorate the tax liability of an estate with respect to property situated in the succession duty levying provinces, since the Act has no power outside its jurisdiction, which is Alberta. The federal tax credit arrangement decreases the double burden on such an estate and not the provincial Act.

The first reason given in an unconditional manner by the provincial government for the introduction of the Act, as this reason was analyzed above, must be seriously questioned. Double taxation can be levied on some parts of an estate, but the conditions delineated above must be fulfilled.

The analysis of the second and the third reasons will be postponed until the Act's liquidity and mobility effect is considered. The analysis of this effect will be made after the Act's effect on the amount of savings and investment is outlined. The Act's general effect on estate holders will be analyzed lastly. Before, however, the evaluation of the economic effects of the Act is undertaken, the

incidence of estate taxes must be considered. The discussion turns now to this problem.

CHAPTER IV

THE INCIDENCE OF ESTATE TAXES

The present day incidence theory, within the framework of a general equilibrium analysis, is composed of all the effects of a particular tax as well as the effects of tax policy on the volume of output and the distribution of income within an economy.

> The traditional distinction between direct incidence and indirect effects involves an arbitrary separation between various elements of the total change which are neither separately indentifiable nor of separate significance as matters of policy.[1]

It will be necessary, however, to review traditional analysis within a narrower framework, which considers the direct effects of any tax to be the only determinants of its incidence.

Basically there were two traditional views with respect to the difficulties in locating the incidence of estate taxes. One view held that "...incidence of death taxes is simple to determine."[2], because the direct burden was not affecting any other business transaction. This view was, in effect, advocating that the incidence of estate taxes cannot be shifted, and the payee of the tax levy felt the total burden of tax. The other view in respect to this controversy held that the "...death duty incidence is not as clear or as simple as has been argued..."[3] because the burden of the tax could fall on other than the payee of the tax since the taxation of wealth transfers involve more

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[1]Richard A. Musgrave, The Theory of Public Finance, (New York: McGraw Hill Book Company, 1959), p. 228.

[2]James K. Hall, Incidence of Death Duties, American Economic Review, XXX (March, 1940), p. 48, n. 5, quoting W.J. Shultz, American Public Finance, (2nd rev. ed.; New York: Prentice Hall Inc., 1938), p. 439.

[3]Hall, ...Death Duties, p. 48.

than two individuals. In the traditional analysis there are five different views as to where the incidence of estate tax lies. These views are enumerated below.

1.) The oldest view, which developed when there was still discussion as to whether or not death duties should be used by governments as a part of their general taxing policy, maintained that if death duties are levied in such a manner that the amount of tax is equal to the total estate, no burden is created.

> The crux of this theory is that "in matters of property in general, and succession in particular...hardship depends upon disappointments; disappointment upon expectation; expectation upon the dispensations, meaning the known dispensations of the law."[4]

Successors expect to receive a bequest. If the tax is levied a part of this bequest is transferred to some other individual if the successor cannot pay the tax from accumulated savings, or the successor's savings are decreased by the amount of tax; irrespective as to which of the above possibilities occur, the successor will be not as well off as he would have been had there been no tax. Consequently the successor will be disappointed. If the tax is levied in the manner that our first view maintains, the successor, knowing that the whole estate will be confiscated by the government, cannot feel disappointed when this in fact happens. This view seriously questions the right to inherit or to bequeath and inherently assumes "that the ends of social justice may be served...through high tax rates on the legal right of succession..."[5].

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[4]Allan A. Tait, The Taxation of Personal Wealth, (Chicago: University of Illinois Press, 1967), p. 169.

[5]Hall, ...Death Duties, p. 48.

This tax-escheat proposal also means that government can obtain part of the necessary revenue without anybody being burdened by the tax. If this assumption is generalized, it seems to imply "...that if by custom and convention a tax becomes accepted, known, and expected, it ceases to be burdensome;..."[6] This view can hardly be accepted as a theory of incidence since any tax levy must be paid by someone, and therefore, it must be felt by that individual.

2.) The second traditional view about the incidence of death duties places the burden on the decedent. There were various arguments advanced about the nature of the death duties under this view. Some economists considered the tax to be a capitalized income tax,[7] others argued that the death duty is an occasional property tax,[8] still others held the view that the duty is an annual tax on capital.[9] The difficulty encountered by the economists in placing the burden of death duties on

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[6]Tait, ...Personal Wealth, p. 169.

[7]J. Westlake, "The Theory of Taxation, with Reference to Nationality, Residence and Property", The Economic Journal, IX (Sept., 1899) argues that "death duties may be regarded as capitalized income tax, and that, therefore, the deceased person...is in effect paying a deferred quota." p. 372.

[8]A. C. Pigou, A Study in Public Finance, (2nd ed.; London: Macmillan and Co., 1929) states that "The characteristics peculiar to death duties are easily set out....these duties are occasional property taxes....they collect a large sum from each property at intervals averaging about thirty years and associated with the death of the proprietor" p. 161. A conclusion similar to that of Pigou, but more specific in presentation, was reached by G.F. Shirras, Science of Public Finance, (3rd ed., London: Macmillan and Co., 1936), Vol. II. p. 542, cited in J.K. Hall, ...Death Duties, p. 50, n. 19.

[9]T. Barna, "The Burden of Death Duties in Terms of an Annual Tax" The Review of Economic Studies, IX. (November, 1941), pp. 28-39.

the predecessor in the traditional incidence theory was that, in the description of the process by which the burden of the duty fell on the predecessor, the economists in effect were describing the economic effects of the duty which was not their original intention. In their Report, the Committee on National Debt and Taxation concurred in general with this view, but was more cautious when it stated that,

> On the whole, we think we have good support for giving primary but not exclusive place to the notion that the incidence of the duty is on the predecessor.[10]

3.) The third view contends that the incidence of death duties is upon the successor. The basis of this argument is that the taxes payable on an estate are due only after the deceased has died; the testator cannot feel the burden; yet since the payment of the tax must involve two legal entities and one is the State, the other must be the successor.

> This (view) has respectable antecedents in that Adam Smith wrote about transfer taxes at death that they "fall finally as well as immediately upon the person to whom the property is transferred"; and Ricardo concurred.[11]

It seems that the followers of this view placed undue significance on the time of the payment of the tax. The bequest to any individual successor is reduced by the amount of tax, but, if a particular successor receives a larger bequest from the testator than he would have had there been no tax levy, the successors whose portion of the estate was thereby decreased by an equal amount were burdened by more tax than their share

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[10]Great Britain, Parliament, Report of the Committee on National Debt and Taxation, (London: His Majesty's Stationery Office, 1927), p. 121.

[11]Tait, ...Personal Wealth, p. 169, n. 8, cites A. Smith, Wealth of Nations, (5th ed.; London: Methuen, 1904) Book V, Chap. 2, Appendix to Articles 1st and 2nd., in n. 9 Tait cites D. Ricardo, Principles of Political Economy and Taxation, (McCulloch ed.; London: Murray, 1876).

should have been. The unequal distribution of estate taxes among beneficiaries, arising out of the testator's action whereby a specified amount is bequeathed to an individual and the tax on this portion is paid out of the total estate, can, in another way, free some beneficiary from the burden of the estate tax. These possibilities do not invalidate the contention of this view, but rather indicate that the situs of the death duties among the successors is indeterminate.

The objection against locating the direct burden with the present view is similar to that of the previous views, namely, that the arguments presented in defence of the location of the direct burden of the tax, can be seriously challenged as being incomplete. This arose because of the inability of the traditional incidence theory to separate the direct burden from economic effects of the tax when, in effect, this was the foundation and starting point of the theory.

4.) The fourth view of the traditional incidence theory is, "...that the burden (of death duties) is partly on the predecessors and partly on the successors, with the proportions indeterminate."[12] This separation of burden is similar to the conclusion offered when a commodity tax is imposed on a perfectly competitive industry's product. There the increase in the price of the product is partly borne by the consumer and partly by the producer. The division of the burden between them depends on the ratio of elasticity of supply to the elasticity of demand in the range of expected price change.

An analogy between income tax and death duty was also used in the illustration of mutuality of the burden. The Colwyn Committee

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[12]Hall, ...Death Duties, p. 56.

argued that

> ...When one compares the Income Tax with the Estate Duty regarding the latter as a kind of postponed Income Tax, one sees clearly the solidarity of the interests of predecessor and successor. The Income Tax, in a concealed way, hits the taxpayer's son as well as the taxpayer himself, and may hit him just as severely. But the damage is separated by a time-gap. In the case of the Estate Duty, the time-gap is bridged, and the damage is at once apparent.[13]

It was also argued that, if one part of the death duty is considered to be a postponed income tax and the second part as a capital levy, then it can be said that the burden attributable to the first part falls on the predecessor and the burden of the capital levy falls on the successor. Beside the difficulty of separating the estate duty into its parts and attributing the proper burden to these parts of the tax, arguments must be presented about the "concealed way" in which, e.g., the income tax affects the taxpayer's son. These arguments were furnished in the above cases, yet clearly, the necessary direct nature of the tax burden was lost. The necessity of realizing that the incidence of death duties affects more than one class of individuals (viz., more than only the decedants or the successors) will be argued when the effects of such taxes are analyzed. Presently, it is emphasized that, the traditional incidence theory was unable to explain the mutality of the tax burden within its framework of analysis.

5.) The fifth view of the traditional theory was that the burden of the death duty falls on no person _per se_. It was argued that since the tax is not levied until the testator dies and ceases to own the property, he can not be held responsible for the tax. The successor

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[13]Great Britain, _...on National Debt and Taxation_, p. 170-171.

does not receive the total bequest (barring the possibility mentioned in the discussion of the third view, supra) because the amount of the tax is subtracted from his share of the estate by legislation before he becomes the owner of the property; therefore the successor cannot feel the burden of the tax. The property was considered to be the payee of the tax.[14] Property, as a separate phenomenon from its owner, is not a very useful concept in the discussion of the incidence of the estate taxes.

In the traditional incidence theory, a complete explanation of the direct burden of the death duties was a difficult matter. The difficulty arose because the liability of the tax was considered to be the incidence of the tax. As soon as it was argued, as was done by some individuals, that the burden of the tax is not necessarily subsequent to the payment of the tax, the explanation of incidence required the delineation of the process by which the burden shifted from the payee to some other individual. This, however, brought the analysis to the need of examining output and distribution effects, yet this was outside the scope of the traditional theoretical framework. Only Musgrave's approach could solve this dilemma. Thus the final word on the incidence of estate taxes must await the economic analysis to be performed in the remaining Chapters of this study.

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[14]Tait, ...Personal Wealth, p. 171.

CHAPTER V

THE EFFECT OF THE ESTATE TAX REBATE ACT ON SAVINGS

The provincial government expects that the amount of savings as the result of the introduction of the Act will increase in this province. The objective in the following paragraphs will be to analyze this expectation in the light of the presently accepted theoretical framework.

Since the provincial Act is subordinate to the federal Estate Tax Act and the resolution as introduced in the House of Commons in reference to the Estate Tax Act is assumed to become law, it is necessary to provide the Act with a frame of reference. The analysis which follows will first determine the probable effect of estate taxes on the amount of saving prior to the existence of the Act and subsequently will accommodate the existence of the Act. Thus, in order to show that the introduction of the Act will increase the amount saved the analysis should indicate that the levy of estate taxes discourages saving both on the part of the predecessor and the successor.

An ideal approach would be to use dynamic equilibrium analysis. This approach would entail the delineation of the first round of changes in the amount of personal incomes, the changes in amount of personal consumption and saving, and the changes in the price level of all factors of production. Also, it would be necessary to describe the possible repercussions of a tax policy change on the level of private investment, and, if the latter would be less than the amount needed to keep the economy on the level of output that the government deems to be desirable, then the analysis would need to show the amount of public investment and

its sources whether they are from borrowing or from new-money finance. After the first round of changes were enumerated, the analysis of the second and successive rounds of adjustments would indicate the final equilibrium position the economy would reach as the result of the change in the government's tax policy. The general dynamic equilibrium analysis is comprehensive and its conclusion is all inclusive.

From the analytical point of view, however, the above process would paralyze the analyst since the simultaneous changes in the variables enumerated above would prevent a conclusion to be drawn from the analysis. In the partial-equilibrium approach which will be followed, only one variable will be allowed to change, and the rest of the variables will be held constant. The use of this ceteris paribus assumption will limit the analysis to a manageable size. Thus, from the point of view of this study, the changes in federal Estate Tax Act (viz., the integration of gift taxes with estate taxes, the increase in the tax rates on medium size estates, the changes in the form of exemptions, and the creation of nontaxation with respect to inter-spousal bequests) will be considered as a change of one variable only (i.e., change in the tax policy of the government), and its effect on the amount of saving will be analyzed, ceteris paribus. No attempt will be made, for example, to analyze the consequences of this change on the economy if the government's revenue will decrease as a result of the above change. In other words, it will be assumed that the government's plan to collect the same amount of revenue after these changes will materialize. Similarly, the source to replace the revenue lost by the Alberta government as the result of the introduction of the Act will not be considered.[1]

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[1]In Appendix 4, the amount of estate and gift taxes collected by the federal government and the amount of estate tax return to the provincial government relative to their total revenues is analyzed.

Reasons For Saving

Saving is undertaken either for future consumption (in economic sense) or for establishing an amount of wealth which is expected to be bequeathed by the accumulator either during his lifetime (in the form of gifts *inter vivos*) or passed on to the relatives or others at the time of his death.

Accumulation for future consumption will not be discussed, nor will the estates which are created by the unexpected death of the accumulator, when in fact the savings were ear-marked for consumption but death intervened. The reason for the exclusion of these forms of accumulation is that the motivation of this sort of saving probably will not change if the form of estate taxation changes.

Saving for the accumulation of wealth is the prime concern. So is the motivation and the characteristics of savers who may be expected to change their saving-consumption propensities when an aspect of the estate taxes changes.

Why do people save for the creation of estates?

> The desire to build up capital possessions is not a simple thing. It is made up of various elements blended in various ways among different men. One element is the desire to be able to exercise the constructive force, which a strong man may find in himself, in conjunction with a large-scale undertaking: another is the desire for that power in society or, perhaps, in politics which great wealth confers: another is the desire for fame or notoriety: another (is) the desire for large income accruing without effort in later life: another (is) the desire for posthumous glory in dying very rich: ....All these motives are concerned only with the lifetime of a man who contemplates saving under the stress of them: the fact that after his death his fortune does not also die is, so far as they are concerned, an irrelevant accident. Along-side of them there is the desire to hand on accumulated capital to his children after the accumulator's death.[2]

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[2]Pigou, ...*Public Finance*, p. 166.

These motives or desires to accumulate are attributable to the decedents-to-be more than to the heirs-to-be. It is possible to distinguish between two broad categories of decedents-to-be for analytical purposes. It will be argued later on that the reaction of one group of individuals will be different on average from the other. Into one category can be placed the modestly endowed decedents-to-be. The second category will consist of the wealthy individuals.[3]

Attention should not be placed entirely on the decedents-to-be. Heirs-to-be also change their saving-consumption propensities as a result of changes in government policy. It is possible to distinguish between the passive and the active heirs[4] and heirs-to-be. The former category would include those individuals who, even if they are heirs to wealthy decedents, depend heavily on the amount of succession since the size of the bequest will determine the future flow of income. These heirs are not the gifted individuals who will be able to augment the size of their inheritance. The active heirs, on the other hand, are those who like their predecessors have a natural affinity for assets. The decrease in the size of their succession or the inevitable decrease of their succession-to-be as the result of the existing tax law, will cause a different reaction among the active heirs than among the passive ones. It is the nature of the active heirs to be able to manage the bequest so as to increase its value above the size of the bequest. The repercussions taken, either by the passive or the active heirs, to the change in tax policy will be different if the predecessor is only modestly

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[3]Carl S. Shoup, Federal Estate and Gift Taxes, (Washington, D.C.: The Brooking Institution, 1966), pp. 86-90.

[4]Ibid., Appendix F by Seymour Fiekowsky, The Effect on Saving of the United States Estate and Gift Tax, pp. 228-236.

endowed than if the decedent-to-be is wealthy.

The separation of the decedents and heirs-to-be into the above mentioned categories will make it possible to analyze the actions taken by the individuals with respect to the amount of saving, as a result of a change in the estate tax legislation. To describe the overall nature of the federal estate tax change, as introduced on October 22, 1968, it is necessary to aggregate the effects of the separate parts of the proposed change on the effective rate of taxes payable relative to the old tax rates.

<u>The Analysis of the Estate Tax Resolution</u>

The increase of tax rates on medium size estates left to other(s) than the surviving spouse will cause an increase in the effective tax rates. The tax free nature of inter-spousal wealth transfer postpones the impact of the increased rate of taxes, since this higher rate will be applied (assuming that there is no change in the tax legislation in the future) to the estate when the properties pass onto the next generation. The change in the form of exemptions is argued to have a neutral effect as far as effective rates are concerned since, although taxes are to be levied on smaller estates than prior to the resolution, the personal exemptions with respect to dependents have changed so as to balance out the liabilities of the smaller estates. In effect the smaller estates under the proposed estate tax are the larger estates prior to the change as the result of the increased personal exemptions.

The effect of integration[5] of gift and estate taxes on the

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[5]The integration of gift and estate taxes is not a new phenomenon. In 1942 the Italian government introduced such a legislation. Later, Colombia introduced a similar law. Shoup, ...<u>Estate and Gift Taxes</u>, p. 12,n.2.

effective tax rate is more difficult to analyze. The reason is that the integration plan of the government contains the cumulative provision. Under it the tax rates are levied on the total value of taxable gifts made by the donor since October 22, 1968. These rates are progressive in nature and significantly higher than they were prior to the date of resolution. Under the old rates there was little inter vivos gift giving.

> Inter vivos gifts...account for only 3.3 per cent of the total value, and display no particularly strong relation to estate size, although the average proportion of the estate in this form is slightly larger in the larger estates...however, ...the probability that some gift will be made increases greatly with estate size: fully 80 per cent of the estates over $500,000 included...gifts, whereas just over 9 per cent of estates under $50,000 did so.[6]

In other countries which impose gift taxes, similar observations were made. In the United States, "Of the 2256 millionaire decedents in 1957 and 1959 combined, only a few more than half made any taxable gifts at all during their life time.[7] This study concerned itself only with decedents whose total estate was more than one million dollars. Since the saving of tax would have been greater for these decedents-to-be if they had undertaken life time gifting, but since in fact only half of them did, it is hypothesized that there are other than tax considerations which govern the donors.

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[6]Kenneth Cheng, John A.G. Grant and Henry M. Ploeger, Ontario Estates in 1963-64: A Tabular Analysis of Personal Wealth Held in Estates Out of Which Ontario Succession Duties Were Paid. (Toronto: Queen's Printer, 1967), p. 9.

[7]Shoup, ...Estate and Gift Taxes, p. 18.

If a comparison is made between the compulsory nature of the time of payment of the tax liability in the case of estate taxes and the chosen time profile of the gift tax liability, the mystery deepens as to why there are so few <u>inter vivos</u> gifts made. An estate is composed of many different kinds of assets, particularly a substantial one. The different assets follow separate appreciation paths. The donor can choose the exact time of his gift(s) to a donee. Conceivably that time will be chosen when the particular asset is in its trough on its appreciation path.[8] Through this procedure substantial gift tax saving can accrue to the donor, and through the donor to the estate. But the estate will be taxed at higher rates and at a time which might not coincide with the desirable troughs of the assets' appreciation path from the tax liability point of view, if the assets are retained. Tax consideration cannot be a significant factor in the determination of the amount of gifts <u>inter vivos</u>. Other reasons which can play an important role in disregarding the readily available tax savings may be conjectured upon. The most important nontax consideration is the uncertainty about the time of death of the donor. Since it is always possible to expect a better occasion for giving life time gifts, the donor can overestimate the length of his life and thereby can create a larger than originally expected estate. Similarly, the donor does not know the amount of funds required to carry him through his life. This might cause him to be conservative with respect to life time giving. The latter, however, may not explain the conduct of those who amass substantial wealth, yet do not distribute it, or at least a large part of it, during their life time.

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[8]Tait, ...<u>Personal Wealth</u>, pp. 175-176.

The next most important nontax consideration may be the desire of the donor to have control over the beneficiaries' actions. This may not be in a form of total control, but it is conceivable that more respect and consideration will be given to an aged relative, if inheritance is expected, than if the bequest is already received by the donee. Coupled with this consideration is that as the age of the donor is increasing, less likely will be (on average) the pressure of the desire to give. This stems from two reasons: firstly, the giving by an aged might be considered to be in contemplation of his death by the survivors; secondly, age can bring a degree of senility with it and this might reinforce the first reason to postpone the gifts *inter vivos*.

Another important nontax consideration, which is more complimentary to the donor is that he may try to avoid spoiling his successors by not giving them a substantial amount of their eventual inheritance too quickly.

The last of the nontax considerations which will be considered is that any giving might be considered as use of one's capital and since uncertainty always exists in respect of the amount of income required over the remainder of one's life, there would be reluctance on the part of donors to increase the chances of insufficient income in the future by distributing their income earning assets. If assets will appreciate in the future as much as they did in the past, the donors by retaining most of their assets increase the estate tax liability.[9]

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[9]Shoup, ...*Estate and Gift Taxes*, pp. 21-25.

Since, with the gift taxes significantly lower than the estate taxes, a relatively small amount of life time giving was undertaken, it can be argued that with higher rates the amount of inter vivos gifts will decline. If this argument is accepted, the integration aspect of the October 22 resolution can be said to have a neutral effect on the effective estate tax rate. The gift tax rates have been increased but the number of gifts may decline as the result, and since according to the resolution the amount of property passed on at death will be taxed by the increased estate tax rates if this tax liability is more than the gift tax liability, it is the estate tax rate increase which will increase the taxes payable and not the integration of estate and gift taxes *per se*.

A summary of the analyses of the separate, and more significant, parts of the resolution on the effective estate tax rates have increased relative to the rates in existence prior to October 22, 1968. With this conclusion it is possible to analyze its effects on the amount of saving undertaken by the two separate kinds of decedents and heirs-to-be.

The Amount of Saving Given Savers' Attributes

Those decedents-to-be who have accumulated a modest amount of wealth and now face an increased tax rate at their death, may increase their consumption over the rest of their life[10] because they may feel that their effort to accumulate is frustrated by the change in tax policy. This assumes that the prospective decedents do not want to leave a specific amount of bequest to their heirs. If they do, then the amount of consumption out of future income must decrease in order to be able to have a given amount after the increased tax liability on their prospective estates. The overall effect of the tax policy on the amount of saving

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[10] *Ibid.*, p. 87.

will depend on the proportion of the decedents who will increase their consumption. The higher this proportion is the more will the amount of saving decline compared with situation before the tax increase.

The active heirs-to-be of the modestly wealthy decedents-to-be may consume less since the increase in the tax rates decreases the amount of their inheritance. This argument assumes that the heirs-to-be are concerned with the pretax amount of their inheritance. If they are not, then the increase in the tax rates will have no effect on their consumption-saving propensity. Active heirs are those who would like to accumulate wealth during their life time, and it is assumed that they have the required talent to augment their capital, therefore, the decreased amount of their inheritance as a result of the increased death taxes increases their average propensity to save. Similarly, but for other reasons, the passive heirs-to-be may increase the amount of their savings. These prospective heirs are dependent on the amount of income they receive from the net inheritance. Since the present value of the income stream from their succession will decrease as the result of higher estate tax rates, the successors may want to compensate this erosion of their income by increasing the amount saved over their life time.

The wealthy decedent-to-be who accumulates to build a family fortune and who is probably saturated with consumption may not change his consumption pattern at all as a result of an increase in the death tax rate.[11] These individuals may, on the other hand, consider the increase in the tax rate as an increase in challenge to build a fortune.

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[11] Ibid., p. 90.

Hence they may increase the amount saved[12] since the increased saving, together with the talent these decedents-to-be have to augment an amount of capital (not necessarily in economists' terminology), will make it possible for these individuals to sufficiently increase their wealth and thereby mitigate the results of higher taxes. These individuals who enjoy the power which is the by-product of wealth, whether it is economic or political power, by increasing the amount saved increase their "consumption" of power concurrently.[13] Both the passive and the active heirs-to-be of the wealthy predecessor may increase the amount saved as the result of change in the tax policy. Their reaction, as was analyzed above, will be for different reasons.

The desire and the volition to save by the predecessor and the successors is not the only characteristic which can cause a change in their consumption-saving propensities. The degree of consanguinity of the predecessor to the successor will be included in the decisions. "The closer the consanguinity, the more likely is the real burden of the duty to fall upon the testator".[14] A modestly wealthy testator may save more if he wants to leave most of his possessions to close relatives. The same may not hold with a wealthy predecessor whose bequests to his family members are probably sufficiently large to decrease the feeling for the need of retrenchment as a result of an increase in the death duties. The majority of large bequests are left to spouses and to children; lesser amounts are left to relatives, and still lesser are

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[12]G. E. Hoover, "The Economic Effect of Inheritance Taxes", American Economic Review, XVII. (March, 1927), pp. 45-46.

[13]Shoup, ...Estate and Gift Taxes, p. 88.

[14]H. A. Silverman, Taxation, Its Incidence and Effects, (London: Macmillan and Co., 1931), p. 195.

left to friends of the testator.[15]

Close and active heirs of a modestly wealthy predecessor, not knowing to what extent can the latter increase his saving, to mitigate the decrease in their succession as a result of the increased tax rates, may increase the amount saved. This reaction can be expected particularly in those cases, where the expectation of the heirs-to-be was based on their lineallity to the decedent. Since the increased tax liability on their succession is a direct threat to their desire to achieve maximum present value of their wealth, by increasing the amount saved, the heirs can move close to that amount of original wealth, which was sought by them before the increased tax rates were introduced, and was used for the estimation of the present value of their wealth.

The close and passive relatives, who have included the amount of the succession as was expected prior to the increase in the tax rates, in their life time consumption function, will feel the need for retrenching. Not only does their succession decrease but so does the present value of the income stream from the received bequest. The degree to which the saving of these relatives increases will be a

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15G. F. Fijalkowsky-Bereday, "The Equalizing Effects of the Death Duties", Oxford Economic Papers, II. (N.S.) (June, 1950) p. 196 analyzed U.K. data to reach this conclusion. It was found that 60.9 per cent of all estates liable for succession duties in Ontario in 1963-1964, were bequeathed to widows, widowers, dependent and non-dependent children. The widow's succession as a percentage of the estates increases with the size of the estates until a size of $200,000 is reached, and decreases thereafter. The dependent and non-dependent children received 36.9 per cent of the total estates. Their portion of the estates increased continually with the size of the estates. Non-lineal relatives received 22 per cent of the total estates passed, but their portion was largest in the case of smaller estates and decreased thereafter. Cheng, Grant and Ploeger, Ontario Estates..., pp. 98-99.

function of their level of income and their degree of kinship to the decedent. At low levels of income the amount saved by the heirs may be low, and cannot be expected to increase significantly as the result of the increased tax rates. The level of dissatisfaction of the heirs, however, may decline as their level of income increases, since the amount saved can compensate for the loss through the taxes. Similarly, the degree of disappointment can decline as the consanguinity of the heirs to the decedent declines, since the certainty with which a bequest is expected tends to diminish as the relationship leaves lineallity.

The close and active heirs of a wealthy testator may increase their savings, if these were seriously expected, yet the heirs of this kind may feel that the loss of succession through increased taxes can be regained through capital gains deriving from their present wealth. The gain may counteract the feeling of loss so as to leave their consumption-saving propensities unaltered. The close and passive relatives of wealthy individuals may retrench more than their active counterparts, since the expectation of capital gains is not a possible alternative to recoup the losses. The windfall nature of the bequest to distant relatives of the wealthy may prevent them from altering their usual consumption practices.

The estimation of the amount, by which the testator can change his consumption-saving propensity, can be made by the "insurance method".[16] The annual premium paid for the insurance which yields an amount equal to the estate duty payable on the testator's wealth, is considered to

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[16] G. Findlay Shirras and L. Rostas, The Burden of British Taxation, (London: Cambridge University Press, 1942), Ch. VI, p. 77.

be the change in the allocation of the predecessor's annual resources as the result of the imposition of the wealth transfer tax. It can similarly be argued that the increase in the estate tax rates would result generally in a similar change in resource allocation. Under the insurance method, the total taxable value of the estate is assumed to stay constant for the remainder of the testator's life. If a modestly wealthy predecessor is considered, the amount saved by this individual will decline provided that the spouse who must own the insurance policy in order that it not be included in the estate, does not have sufficient annual earnings to cover the annual insurance premium. If the converse is the case, the testator's saving habit might not change. The insurance premium on a large estate could be sufficiently significant to cause increased saving by the predecessor, particularly if taxes are payable on the gifts made to the spouse. These transfers can be made to help the spouse pay for the annual insurance premiums, as long as the spouse has complete ownership of the insurance policy. In the wealthy predecessor's case, it was similarly assumed that the spouse does not have sufficient and independent income.

The reaction of the heirs-to-be to an increase in the estate tax rates, under the "insurance method" of estimation of the annual burden, can be neglected provided that the successors will not transfer already saved amounts to reimburse the spouse of the testator for the insurance premium. If the transfer does take place, the heirs-to-be may want to regain the "lost" savings by decreasing their present consumption. This decision will partly depend on the amount by which the

successions increase as the result of the insurance coverage relative to their loss of present saving. If the present value of the increment in the individual or total succession is more than the present value of the annual premiums, the successor should not change his consumption habit. Another factor that might be included in the decision making process is the change in the difference between the marginal utility of future and present consumption after the successors became cognizant of the increased bequest due to them. Various possibilities are present but as long as the future consumption is valued less as the result of the insurance, the present consumption will increase, and conversely if the present consumption became less valuable. In order to include the heirs of wealthy testator in this analysis, the term consumption includes the enjoyment of power, prestige, etc. arising from savings or wealth.

The age of the predecessors and the successors can influence their reactions to an increase in the tax rate. The least affected will probably be the young testators. Whether it is assumed that a young person will become a modestly wealthy or a wealthy predecessor, the amount of the estate to be passed on at death is hard to estimate, as is the change in the savings pattern.[17] The savings of young families in the form of life insurance cannot be argued to be a response to a change in the estate tax rates, since the motive is most likely to be that of replacing the income stream lost caused by an early death of the head of the family.[18] The young testators-to-be

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[17]Fijalkowsky-Bereday, ...Effects of the Death Duties, p. 191.

[18]C. T. Sandford, Taxing Inheritance and Capital Gains, (Worcester: Institute of Economic Affairs, 1965), p. 23.

can expect the estate tax law to be changed during their life time which can cause a tax rate change as well.[19] The aged modestly wealthy testator, in reaction to an increase in the tax rates, may begin to dissave or spend out of his capital within the possible configurations of the motives for saving analyzed above and his consanguinity to heirs. For an aged individual, it is difficult to purchase life insurance which is to cover the probable estate duty liability and whose premium is sufficiently small to be paid out of annual income. If an insurance policy is carried over from younger years, then dissaving may take place to decrease the estate to an amount for which the insurance policy covers the tax liability. The aged wealthy individuals facing higher taxes, which were introduced late in their life, may do little to change their saving pattern. The motives to accumulate wealth will be satisfied during their lifetime; the heirs would not suffer undue burden since charitable donations may decrease in order to increase the net amount of wealth distributable among the heirs. By changing the proposed distribution of his possessions, the wealthy testator can achieve the same result as the modestly wealthy testator is able to do only through dissaving or consumption of some proportion of savings.

The middle age decedents-to-be are perhaps the most affected by a change in the tax policy. Particularly those individuals who save up their modest wealth during their life time,[20] since only

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[19]Hoover, The Economic Effects..., p. 46.

[20]It was estimated that of all the wealth possessed in U.K., at any particular time, one-third is inherited from previous generation, another one-third is created by a combination of luck, talent and business opportunity with some amount of early inheritance and a final one-third is created during somebody's own life by the volition and determination of the individual. Fijalkowski-Bereday", ...Effects of the Death Duties, p. 194.

through increased amount of saving can the same amount of wealth be accumulated after the tax increase. Those individuals, who rely mainly on their talent to attain wealth through capital gains, may not change their saving pattern.

The young heirs-to-be of either the modestly wealthy or wealthy decedents are likely to be little affected by the change in the estate tax rates, since the bequest is not expected to be received by them for a long period of time and the tax laws can change in the meanwhile. This argument is based only on the consideration of their age and not on their other characteristics such as motives and relationship to decedent which might be stronger and outweigh their age. The middle aged heirs are expected to retrench their consumption of the estate tax rates increase. Their possible reaction to such an occurrence was analyzed above.

The previous analyses were made on a micro level: individual testator's and heirs' reaction to an increased estate tax was considered, given various characteristics which were assumed to influence their saving decisions. On an overall or macro level, the above indeterminate conclusions are even more prevalent. Since the amount of saving in the economy is a function of other considerations beside estate taxes, any generalization must be defended by the *ceteris paribus* assumption. The adjustment in saving will, if the previous analyses are accepted, change so as to increase the amount saved, if there are more active heirs-to-be in the population than passive heirs-to-be. The increased saving by these individuals may be offset by a change in the time preference of consumption by all those individuals who save for future

consumption. Although saving for future consumption has not been included in the analysis, since this kind of saving is not for estate creation, when the overall level of saving is considered, the inclusion of this sort of saving is mandatory. The change in the time preference of consumption may occur irrespective of any change in the estate tax rate.

It is possible to marshall arguments together that would show that the decedents would increase their saving, and also that the heirs would increase their saving, as a reaction to an increased death tax, if the characteristics of the individuals are chosen with that goal in mind. It is also possible to argue, if the proper characteristics are picked, that both the predecessors and the successors would decrease their savings, or that either the decedent or the heir-to-be would increase his saving while the other would decrease his saving.

> So little is known about how people do react to the threat of a distant but inevitable tax that it is impossible to assert confidently that the estate tax will on balance reduce saving by the prospective decedent and his prospective heirs, viewed together.... (If so viewed) decedents and heirs might increase their net wealth, after tax, over what it would have been if no such tax had existed.[21]

This refers to an introduction of the estate tax, and the concern here is with an increase in the rates of such a tax. It is contended here that the two changes in the tax policy are similar, and that the effects created by either of them are indistinguishable. The summary of the above analyses leads to the conclusion that the effect on saving of an increase in the estate tax rates is indeterminate with a slight bias toward an increase in amount saved.

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[21]Shoup, ...Estate and Gift Taxes, p. 89.

By reversing the above conclusion it is possible to evaluate the expectation of the Act. As was mentioned above, it is expected that as the result of introduction of the Act the people of Alberta would save more and thereby increase the wealth accumulation in this province. From the above analyses and the conclusion derived from them, it is possible to state only that theoretically the saving patterns of predecessors and heirs after the introduction of the Act should remain neutral to this change with slight bias to decrease the amount saved. It is possible that saving will increase, but the occurrence requires special configuration of motives to save, consanguinity of heirs to predecessors and a particular age distribution of the population within which the accumulated wealth is transferred.

CHAPTER VI

THE EFFECT OF THE ESTATE TAX REBATE ACT ON INVESTMENT AND MOBILITY OF WEALTH

The Alberta government separately from its expectation of an increased amount of saving, as the result of the introduction of the Act, also expects the amount of investment in Alberta's industrial and agricultural development to increase.

It is also contended that the legislation should induce individuals together with their wealth to migrate to Alberta. These expectations should increase the amount of investment in the province. In the following analysis the Act's effect on investment is considered first and then its effect on the mobility of wealth.

Investment, for the remainder of the analysis, is used in the national income accounting sense. Thus, only expenditures on producers' goods, i.e., factors of production such as plant and equipment are considered to be of importance. This definition rules out, for the time being, the analysis of personal asset portfolios. This question will be taken up in the next chapter. With respect to investment, the analysis will concentrate on the change in the incentives to and the change in the amount of investment resulting from a change in the estate tax rates, *ceteris paribus*. Thus, it is assumed that whatever variables the individuals, the private businesses and the corporations included in their investment decisions, will be maintained in their present investment function. The only variable that has changed in their decision function is the increase in the estate tax rates. The theoretical nature of the analysis permits the separation of the investment sources into

those emanating from individuals, from private businesses and from corporations. The available data only permits the separation of private investment from that undertaken by government. Furthermore, it is argued that "Investment spending decisions are to some extent made by persons who cannot make corresponding decisions on saving. They spend, on investment, other peoples' money..."[1] This makes it possible to separate the analysis of investments from that of saving. The conclusion reached in the latter was that the amount saved by the predecessors and the heirs-to-be viewed together is expected to remain relatively unchanged with a slight bias toward an increasing amount saved in reaction to the increased federal estate tax rates. Yet whether the amount saved in any particular year had increased or decreased, the separation of savers from those who invest makes it possible to analyze the reaction of the investors alone without breaking the continuity of the analysis. This is not to say that the amount of saving is not important when the amount of investment is analyzed. Saving must equal investment when the whole economy is considered. The purpose of the analysis is to delineate the effect of the increased estate tax rate on the investment. If the change in the tax policy causes a different change in the amount saved from that of investment, other monetary or fiscal measures must iron out the potential discrepancy.[2]

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[1] Ibid., p. 91.

[2] Ibid., p. 92.

Investment by Individuals

An individual investor's incentive to invest may change as a result of an increase in the estate tax rate. If it is assumed that the full burden of such a tax is on the testator,[3] he may consider that the risk on all future investments has increased to an extent that some projects which were considered to be potential investment media are no longer attractive. In the previous analysis it was shown that to try to locate the ultimate, full burden of the death taxes was to seek after impossibilities. Burden in this sense means payment of the duty, and it was argued that burden can precede the payment of a tax as the result of repercussions taken by individuals involved in the transfer of wealth. By disregarding the question of burden *per se*, then only the reaction of investor to the change in the tax policy, given a certain amount of saving earmarked for investment, is of importance. Provided that the investor-testator-to-be wants to leave the heirs a certain amount of wealth at the time of his death, riskier investments will have to be considered since estate tax will diminish his after tax wealth. Given this desire to bequeath, the younger an individual, the less urgency there is to consider risky investments since tax laws can and do change over time. Another consideration in this respect is the flow of annual income from a riskier direct investment. Older individuals, by and large, have a larger need for income than do younger ones since the former are usually past their income earning age. For a younger individual (testator-to-be), the increased annual income,

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[3] H. S. Bloch, "Economic Objectives of Gratuitous Transfer Taxation", *National Tax Journal*, (June, 1951), p. 142.

creating a higher income tax liability, might act as a deterrent to undertake riskier investment. Yet by disregarding the risk characteristic of investments and the provision that a specific amount of wealth is planned to be transferred by the testator to his heirs, the incentive to invest after the change in the tax rates may not change at all. In the present analysis, the repercussions by the heirs-to-be can be neglected since it is assumed that the reaction of the testator-to-be will represent the reaction of all parties who are going to be involved in the transfer of wealth.

The analysis of individuals' investment undertaking intrinsically contained the following assumptions. Firstly, direct investments are available for any amount of saving a testator might have. This is unrealistic since direct investments either in industry or in agriculture require some minimum amount of funds. Secondly, the amount of risk in any investment project is commensurate to the benefit derived from the project. Hence, if the risk increases, the revenues from the investment increases proportionately. Lastly, investment is undertaken by the same person who has saved the funds. The separation of the behavior of savers from that of investors was made above because, as it will be argued later, a large part of the private investment is undertaken by individuals who not only do not make decisions as to the amount of funds saved for estate purposes, but also do not react in any way to an increase in the estate tax rate. The above analysis considered the individual's action in isolation; when the reaction of all individuals is considered, the total individual incentive to invest may change very little.[4]

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[4]Shoup, ...Estate and Gift Taxes, p. 93.

Investment by Privately Owned Businesses

Owners of private businesses facing an increased estate tax rate, beside considering their individual estate positions, must take into account the viability of their business as well. As individuals their incentives to invest may have decreased since, provided that the investment decisions are made correctly, more investments means a larger problem of valuation of their share of the business at the time of their death. From the business point of view, however, some investment is necessary. To argue that the estate tax

> ...is to reduce investment because of its effect on incentive, we must postulate the case of a potential demand for tangible capital goods...that does not develop because the would be purchaser is discouraged by the death... (tax). Such a result seems unlikely.[5]

There are other views concerning the effect on investment incentives. One view is that the high income tax rate coupled with an increased estate tax will discourage new investments to be undertaken by private business.[6] The first part of this argument is concerned with the amount of funds available for investment and not with incentive to invest *per se*. By extending the second part, it can be held that if the investments are discouraged, the growth of private businesses will decline. This view also holds that the risk capital expended by private businesses will decline. If the endeavor is successful, the estate tax will progressively take a large part away from the estate

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[5] *Ibid.*, p. 93.

[6] John K. Savage and D. Van Den Bulcke, *Transfer Taxes: Their Effect on Productivity and Control of Our Economy*, (Toronto: Ontario Economic Council, 1968), p. 28.

and simultaneously increase the valuation problem as well. The conclusion of this argument was that special consideration should be given to private businesses when they are passed from one generation to another. The difficulty the private businesses have with respect to the estate taxes should be considered in the light of their contributions to the growth of the national economy.

> This is a matter on which opinions differ very much; on the whole Americans seem to take a more rosy view of the contribution of the small company than is usual in this country (United Kingdom). In any case the importance of the problem hardly seems to warrant a major change in the tax structure.[7]

The contribution to the growth of the economy by private businesses perhaps can be measured by the size of their investment. More specifically, by the change of their incentives to invest, or whether or not, and if so to what extent will idle cash balances be held as the result of the change in the estate tax rates. "How large this kind of investment is relative to total investment spending, we do not know, but it cannot be very large; it does not include investment spending by widely held corporations".[8] This is in reference to United States, yet it can perhaps be generalized for Canada as well.

Institutionalized Investment

Up to now the analysis concentrated on those individuals who can save and make investment decisions either concurrently or subsequently. The purpose was to analyze how their incentive to make direct investments can change given some of their main attributes and a change

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[7] U. K. Hicks, "Direct Taxation and Economic Growth", Oxford Economic Papers, VIII. N.S. (September, 1956), p. 314.

[8] Shoup, ...Estate and Gift Taxes, p. 93.

in the estate taxes. The conclusion was that incentives are not expected to change significantly, and that such a change, if it happens, is not expected to have serious repercussions on the economy as a whole because of their relatively small contribution to total investment. Corporations, where the management and ownership are separated, the change in the amount of personal savings or the change in the personal incentive to invest is postulated to make very little difference to the incentive of the corporation to invest. The corporate executives responsible for the investment decisions have different utility or preference functions from those of the shareholders.[9] The possibility of this occurrence rests on the assumption that the managers' maximum satisfaction is derived from other than profit maximization. The last word in this controversy has not been yet written, but the plausibility of the argument cannot be denied.

The corporations are undertaking the bulk of the non-government investments. The objective here is not to define the variables which govern such an investment, but to consider whether the incentives of the managers to invest changes when the estate tax rates increase. The modern day manager does not have to be a wealthy individual to be able to have effective control over a large amount of accumulated savings in different assets form. His special training or education provides him with this opportunity. The professional manager may or may not have any share of the company which he manages. The essential point is that it is not necessary for him to own part of the company unless the widely held corporation has retirement or saving plans which buy regularly

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[9]Robin Marris, "A model of the 'Managerial' Enterprise", The Quarterly Journal of Economics, LXXVII (May, 1963), pp. 185-191.

from the joint contributions of employees and employer a certain amount of equity.

The corporation executives will be concerned with vicissitudes of business climate when making their investment decisions. The actions of the rival companies will also influence the managers. "The decision makers of widely held corporations are not likely to be influenced by the prospective death taxes on stockholders",[10] since it is argued that other more important forces, which can threaten the viability of an enterprise are considered before estate tax rates are. To reiterate, the question posed here was not whether the corporations change their investment plans from one period to another, but rather to what extent the change in the estate tax rate influences the variation in the investment profile. The conclusion is that its influence is insignificant.

Data is not available to indicate the exact relative proportion of the institutionalized investment to total non-government investment in Alberta. Institutionalized investment means that amount which is expended by others than individuals and private businesses. Previously it was stated that the provincial government, as the result of its Act, expects that the amount of investment will increase in the province. This increment is considered to be an addition to the change which occurs irrespective of the Act. In the above paragraphs, it was argued that only a small portion of the investment is not institutionalized non-governmental undertaking. Furthermore, incentive to invest is least likely to change where its effect would be most significant, *i.e.*, in the case of corporations. To analyze the possible effect of the Act

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[10] Shoup, ...*Estate and Gift Taxes*, p. 93.

on private business and individual investment where incentives can, even if to a small degree, change as a result of a change in the estate tax rate, it is necessary to estimate firstly, the non-governmental investments in Alberta.

Table 1 contains the non-government investments in Alberta since 1951. This date was chosen since no data is available for the period prior to 1951. The investment figures were obtained by deducting the government and housing investments from the recorded total investments for the respective years. The latter deduction was made since the provincial government expects the investment expenditures on industrial and agricultural development to increase and not necessarily on private housing.

TABLE 1

DIRECT NON-GOVERNMENT INVESTMENTS IN ALBERTA FOR 1951-68 PERIOD

(In Millions of Dollars)

Fiscal Year	Amount of Investment	Fiscal Year	Amount of Investment
1951	$342.6	1960	$ 612.2
1952	510.1	1961	641.5
1953	575.2	1962	542.7
1954	507.2	1963	648.6
1955	452.1	1964	739.9
1956	596.9	1965	922.8
1957	529.2	1966	1,072.8
1958	536.6	1967	1,096.3 (a)
1959	$573.9	1968	$1,181.3 (a)

(a) Estimates.

Source: Canada, Department of Trade and Commerce and Dominion Bureau of Statistics, Private and Public Investments in Canada, (Ottawa: Queen's Printer), Outlook and regional estimates for years 1951-68.

Column (2) of Table 2 contains the after-tax personal income for selected income classes for the period 1951-66 taxation years. The lower limit of the income classes considered was $8,000. There was no upper limit set. The choice of the lower limit was made since it is assumed that individuals earning less than $8,000 a year are not able to save for estate creation purposes. Columns (3) to (6) indicate the amount of earnings that can be saved given the respective percentages. Thus, in 1951 the total after-tax income for the income classes above $8,000 was $56,820 thousands. Out of this amount, if the earning recipients saved 5 _per cent_, _i.e._, column (3), this would have amounted to $2,841 thousands; 10% saving would have yielded $5,682 thousands, etc.. These latter amounts are total savings and do not fairly represent the amounts which were saved for estate creation _per se_. Nor do they represent the propensities to save of all income classes selected. Since the individuals in the $8,000 - $9,000 income range may not be able to save, _e.g._, 5 per cent of their income, whereas individuals in the more than $25,000 annual income range can. It is assumed that the saving propensities average out throughout the selected income ranges to be the percentages given in the respective columns (3) to (6). A more serious deficiency of the savings data to be presented below is that the amounts, for the various years with the given savings ratios, are total savings which are assumed to be for creation of estates, yet _a priori_ cannot be affirmed. It can be maintained that, _e.g._, an individual having an after-tax annual income of $8,000 cannot save 5 _per cent_ of his income for accumulation of wealth only. This objection is more forceful as the savings ratios increase in magnitude.

To mitigate the objection, it is assumed that at the lower part of the saving spectrum the deficiency of saving ability for estate creation purposes of the lower income class (within our selected range) will be offset by the savings of the upper income ranges. As the propensity of saving ratio increases, the amount of the contribution by the lower income classes decreases. Thus, at the high rates of saving, only the upper income classes save.

No adjustment was made to reflect the decreasing purchasing power of income. The investment was presented in current dollars as well. The object of the analysis is to compare the amount of private annual saving with the non-government investment expenditures in this province. Both of the variables are in current dollars which makes the conversion to constant dollars less important.

TABLE 2

ALBERTA AFTER-TAX PERSONAL INCOME FOR SELECTED INCOME RANGES IN THE PERIOD 1951-66

(In Thousands of Dollars)

Taxation Year	Annual Income After Tax	Amount of Saving with Various Saving Ratios			
		5%	10%	20%	40%
(1)	(2)	(3)	(4)	(5)	(6)
1951	$ 56,820	$ 2,841	$ 5,682	$ 11,364	$ 22,728
1952	73,246	3,662	7,325	14,649	29,298
1953	76,574	3,829	7,657	15,315	30,630
1954	75,788	3,789	7,579	15,158	30,315
1955	94,217	4,711	9,422	18,843	37,687
1956	115,073	5,754	11,507	23,015	46,029
1957	137,409	6,870	13,741	27,482	54,964
1958	159,530	7,977	15,953	31,906	63,812
1959	187,893	9,395	18,789	37,579	75,157
1960	191,796	9,589	19,178	38,355	76,710
1961	209,395	10,470	20,940	41,879	83,580
1962	260,215	13,011	26,022	52,043	104,086
1963	284,956	14,248	28,496	56,991	113,982
1964	322,206	16,110	32,221	64,441	128,882
1965	409,601	20,480	40,960	81,920	163,840
1966	$574,423	$28,721	$57,442	$114,885	$229,769

Source: Canada, Department of National Revenue, Taxation Statistics, (Ottawa: Queen's Printer), for the taxation years 1951-66.

From Table 2 it is observable that the annual income, after tax, has increased tenfold in the selected income classes during the fifteen year period 1951-66. In a similar manner the various calculated saving amounts experienced an identical growth. The next objective is to select _a priori_, the most probable range of saving ratios. Given the 40 _per cent_ saving rate out of the total income for 1966, $229.8 millions would have been saved for estate creation purposes. Previously it was assumed that the saving ratios at the head of the columns are averages for all of the income ranges. This assumption will hereunder be further analyzed.

Table 3 shows a more detailed breakdown of the total annual income. Three categories of income are considered. These are: income between $8,000 - 10,000, $10,000 - 25,000 and above $25,000. The classes were divided by the relative ability of income earners to accumulate transferable wealth. The marginal income class is that of the $8,000 - $10,000. The study of the Ontario estates found that there was a 15 to 1 ratio between the size of the estate and the predecessor's income.[11] Savings invested into family dwellings are not considered to be wealth creation in the present frame of reference, since the analysis now is of direct investments into industrial and agricultural development. From the investment amounts in Table 1, the housing investments were also excluded. Given this exclusion the individual in the $8,000-10,000 income class will find it difficult to save any more than 5 _per cent_ for the future generation in mind. The predecessors-to-be in the $10,000 - 25,000 category will find it easier to accumulate wealth, and the income group above $25,000 will have the least difficulty.

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[11]Cheng, Grant and Ploeger, _Ontario Estates_..., p. 13.

With the 40 per cent saving rate for 1966, the saving would have amounted to $229.8 millions. Given the marginal saving nature of the $8,000-10,000 income class which accounted for 38.2 *per cent* of the total annual earnings for that year (last row and column (3) of Table 3), the individuals in the other two income categories would have had to save 62 *per cent* of their income. This seems highly unlikely. With the 20 *per cent* saving rate for the same year, the saving could have been as high as $114.9 millions (last row and column (5) of Table 2). Employment the earlier argument of this paragraph, would yield a saving ratio of 29.2 *per cent*. This is also considered to be an unlikely occurrence. Thus, it is concluded *a priori* that the saving ratio for estate creation purposes is less than 20 *per cent* for the selected income range.

TABLE 3

AMOUNTS OF INCOME FOR INCOME CATEGORIES AND THEIR PROPORTION OF THE TOTAL AFTER-TAX INCOME FOR THE PERIOD 1951-66

(Income Amounts in the Table in Thousands of Dollars)

	$8000-10000		$10000-25000		$25000 and Over		
Taxation Year	Income Amount	% of Total	Income Amount	% of Total	Income Amount	% of Total	Annual Income After Tax
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1951	$ 16,911	29.8	$ 31,571	55.6	$ 8,338	14.6	$ 56,820
1952	19,591	26.7	42,329	57.8	11,326	15.5	73,246
1953	22,565	29.5	43,534	56.9	10,475	13.8	76,574
1954	19,590	25.8	42,384	55.9	13,814	18.3	75,788
1955	23,632	25.2	53,649	56.9	16,936	17.9	94,217
1956	36,856	32.0	61,223	53.2	16,994	14.8	115,073
1957	44,400	32.3	73,084	53.2	19,925	14.5	137,409
1958	54,067	33.9	81,176	50.9	24,287	15.2	159,530
1959	65,313	34.8	97,306	51.8	25,274	13.4	187,893
1960	68,362	35.6	99,325	51.8	24,089	12.6	191,776
1961	72,482	34.6	110,946	53.0	25,976	12.4	209,395
1962	89,809	34.5	141,476	54.5	28,939	11.2	260,215
1963	102,629	36.0	153,885	54.0	28,442	10.0	284,956
1964	121,243	37.6	164,216	51.0	36,747	11.4	322,206
1965	149,482	36.5	216,115	52.8	44,004	10.7	409,601
1966	$219,608	38.2	$297,191	51.7	$57,624	10.1	$574,423

Source: Canada, Department of National Revenue, Taxation Statistics, (Ottawa: Queen's Printer), for the taxation years 1951-66.

From Table 3 it can be seen how the proportions of the various income categories changed over the period analyzed. The $8,000-10,000 category accounted for more than 38.2 per cent of the total income for the selected range of income classes in 1966, compared with 29.2 per cent in 1951. The $10,000-25,000 and over $25,000 categories experienced a decline from 55.6 to 51.7 per cent and 14.6 to 10.1 per cent respectively. Only the $8,000-10,000 category matched the tenfold increase of the total annual income.

In Table 4 the comparison is made between the annual savings with the given ratios and the annual investments.

TABLE 4

AMOUNT OF SAVING AS A PER CENT OF INVESTMENT WITH THE VARIOUS SAVING RATIOS FOR THE PERIOD 1951-66

(All Entries in the Table in Per Cent)

Taxation	Saving Ratios				Taxation	Saving Ratios			
Year	5%	10%	20%	40%	Year	5%	10%	20%	40%
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1951	0.8	1.7	3.5	7.0	1959	1.6	3.2	6.5	13.0
1952	0.7	1.4	2.8	5.6	1960	1.5	3.1	6.2	12.5
1953	0.6	1.3	2.6	5.3	1961	1.6	3.2	6.5	13.0
1954	0.7	1.4	2.9	5.9	1962	2.3	4.7	9.5	19.1
1955	1.0	2.0	4.1	8.3	1963	2.1	4.3	8.7	17.5
1956	0.9	1.9	3.8	7.7	1964	2.1	4.3	8.7	17.4
1957	1.2	2.5	5.1	10.3	1965	2.2	4.4	8.8	17.7
1958	1.4	2.9	5.9	11.8	1966	2.6	5.3	10.7	21.4

Source: Calculated from: Canada, Department of Trade and Commerce and Dominion Bureau of Statistics, Private and Public Investments in Canada, (Ottawa: Queen's Printer), Outlook and regional estimates for years 1951-68.

Canada, Department of National Revenue, Taxation Statistics, (Ottawa: Queen's Printer), for the taxation years 1951-66.

In the earlier part of this section it has been claimed that the majority of direct investments are made by individuals who are not expected to change their incentives to invest when a change occurs in the estate tax rates. These individuals are the executives of widely

held corporations. No specific public data is available to prove this allegation. The steps taken in the previous pages to mitigate this problem were as follows: the non-government investments for Alberta were presented in Table 1, then total income and saving amounts for a selected income range with specific saving ratios were calculated in Table 2; this was followed by the analysis of the proportions of income of the various income categories to the total income, the selected income range in Table 3; and finally the various entries in Table 2 from column (3) to (6) were divided by the entries of Table 1. The results are shown in Table 4.

In the discussion of Table 3, the range of saving ratios was decreased from 0-40 per cent spread to 0-20 per cent. Concentrating on the use of this reduced range of saving ratios will make it possible to state that the maximum direct individual investment in Alberta, given the above assumptions, cannot be more than 10.7 per cent of the total non-government investment in 1966. This proportion of individual investment decreases as the saving ratio decreases. At 5 per cent rate of saving, such an investment is 2.6 per cent of the total. In 1951, the similar saving rate contributed a mere 0.8 of one per cent to the total. The effects of banks and financial intermediaries were considered neutral with respect to individual investment, which is an over-simplification. However, if individuals deposit their saving into a financial institution, the credit creation process will have the usual multiplicative effect on the availability of credit *ceteris paribus*. Here it is assumed that individuals will not use credit to build an estate.

The conclusion of the analyses of incentives to invest was that individuals who have the correct combinations of characteristics, may

change their incentives as a result of an increase in the estate tax rates individually, but collectively the incentives cannot be expected to change significantly. The immediately preceding paragraphs have shown the extent of individual direct investment and found it to be relatively small compared with the total investment. Therefore, the government's expectation of increased individual investments resulting from its introduction of the Act, cannot be accepted. Corporations may increase their investment in the province, but it was argued that this is unlikely to be a reaction to the Act.

Mobility of Wealth

The second part of the present analysis with respect to the Act's effect on investment is the consideration of the effect the Act may have on the mobility of individuals and their wealth into and out of the province. On April 15, 1966, Premier Manning, introducing the resolution which was the preamble of the Act, stated that, "...millions of dollars are lost to the Canadian economy through individuals establishing domiciles outside Canada in jurisdictions where estate taxes are not imposed..."[12] The loss, it is claimed, is not only in the form of wealth but also in the form of potential income taxes which are lost as a result of the establishment of the 'domicile by choice' in the tax haven. The magnitude of the emigration was not known by the government either at the time of the introduction of the Act in 1967 or a year later.[13]

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[12]Government of Alberta, Journals of Legislative Assembly..., p. 124.

[13]This was revealed during the interviews arranged with Mr. F.G. Stewart, Deputy Provincial Treasurer and F.G. Wyatt, Administrator of the Act during November, 1968.

> Research into the extent to which tax havens are being utilized,...does not support, to any significant degree, the allegations that Canada is experiencing a death-duty-caused flight of capital. In fact, no evidence of wealthy Albertans acquiring domicile in a tax haven country was encountered.[14]

With respect to immigration of individuals wishing to take advantage of the provincial tax rebate on their estates at the time of their death, the provincial government is experiencing considerable success. The reasons cited which discourage wealthy individuals to establish domicile of choice in the tax haven countries were: the unsuitable business climate, unfavorable tax policy with respect to income derived from investments, lack of investment opportunity and unstable political environment.[15] These reasons are not applicable to this province.

There are two different kinds of immigrants that can be distinguished. First are those who are establishing domicile in this province and were residents of other Canadian provinces. The problems encountered by these individuals are not as numerous as encountered by non-resident non-Canadians who constitute the second kind of immigrants. The latter can never be certain that the country of their origin will accept 'the domicile by choice' since its interpretation is based on intent which can be given different meaning by different jurisdictions. Furthermore, the non-Canadian residents may find it difficult to transfer their wealth from some countries such as the United States, United Kingdom, or France, whose governments have placed restrictions on mobility of funds out of the respective countries. Yet some wealthy individuals judging

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[14]Savage and Van Den Bulcke, Transfer Taxes:..., p. 41.

[15]*Ibid.*, p. 39-41.

from the information the provincial government received since the introduction of the Act, find it possible to at least attempt the establishment of the requirements of the Act with respect to domicile and situs of property.[16]

The economic effects of such an influx of wealth to the province cannot, *a priori*, be determined since the effect will depend on the size and the nature of the transferable wealth. Some comments, however, are possible. One obvious advantage accruing to the province is the increase in the income tax collection. Wealthy individuals, as was argued before, at the time of their death have an observable 15 to 1 ratio between their estates and their annual income. Individuals taking up residence in the province, for the reason of the Act, can be assumed to belong to the higher income class, therefore paying higher than average amount of income taxes.

Another effect which can already be observed is that "Up to the end of 1968, a total of 123 new transfer agents had been established in the province."[17] The establishment of transfer agencies for equities of widely held corporations is a *sine qua non* in the creation of situs of such equities. The fulfilment of situs regulations are mandatory in order to receive the estate tax rebate on those securities whose head office is not situated in Alberta. In reference to the increased number

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[16]During the interviews in November, 1968, some information was made available in the form of a letter, concerning the number and origin of non-Canadians who have taken the first steps in establishing their Alberta resident requirements. The confidential nature of this information was asked to be maintained by not printing it. The latter can, however, be inspected.

[17]*The Albertan*, January 22, 1969, p. 1.

of transfer agents, no mention was made whether they are new offices of trust companies or just the creation of registry in already existing trust offices. In the latter case, the multiplier effect would be considerably smaller than in the case of former occurrence, since it would entail only the maintenance of a transfer book. The scope of this sort of operation may not require additional staff at all.

One of the reasons upon which the Act was based, namely, that wealth is being lost to Canada because of migration of individuals to tax haven jurisdictions, can be rejected since no evidence was found to substantiate this reason. During the 18 months of its operation, the Act, by creating a Canadian tax haven (as far as estate taxes are concerned), has attracted wealthy individuals. If immigration will continue to be observed, the expectation can be said to be fulfilled.

CHAPTER VII

THE EFFECT OF THE ESTATE TAX REBATE ACT ON ESTATE LIQUIDITY

The provincial government, in addition to the previously analyzed expectations, by introducing the Act hoped to mitigate the financial difficulties that estates experience when inter-generation transfer takes place. One of the reasons given for the enactment of the Act (c.f. supra,) was that an inflationary trend increases the value of real property which creates financial hardship on the successors. The financial difficulty or hardship occurs because the estate does not have sufficient liquid assets to discharge the estate tax liability. Those assets which can be converted into cash with relative ease and without a decrease in their value are called liquid assets.

The charge that estate taxes create financial hardship on an estate and that in some cases some part of the transferred wealth has to be sold, can be analyzed either theoretically or empirically. As will be seen below, the conclusions arrived at by the two forms of analyses are different. The reason behind the difference is that in the theoretical analysis, individual cases are considered, whereas in the empirical studies, all the estates administered within a period of time are analyzed. In our previous analyses, this distinction between theoretics and empiricism was harder to make since the inquiries were aimed at intentions, propensities and characteristics of individuals making decisions concerning their wealth. In the present case, an inquiry can be made of the outcomes of these decisions, and light can be shed as to how individuals adjusted their asset position to minimize

the impact of the estate taxes.

The theoretical analysis of the deficiency of liquid assets to meet the tax liability considers three separate categories of cases. These are, individuals having various assets in their asset portfolio, owners of private businesses having all or the majority of their wealth in the form of ownership in their businesses, and farmers passing the financially illiquid land and implements to the next generation.

The main reasons for the creation of financial difficulties in the case of individuals having various assets in their possession are the uncertainty about the length of life and that about the exact amount of estate taxes levied on the particular estate. The cash portion of the estates does not increase with the increasing tax rates even when this amount is combined with the proceeds of life insurance policies taken on the predecessor's life.[1] This decline in itself does not prove the existence of the shortage of liquid assets, since other assets which can be qualified into the similar category can increase to counterbalance the decrease in cash.

Uncertainty can hardly be blamed to be a general reason for the liquidity difficulties of an estate. In the cases where the testator-to-be dies unexpectedly, the chance occurrence contributed significantly to the problem. Yet in other than these exceptional cases, the mere overestimation of one's life and lack of action to obviate the approaching tax liability should not be considered to be the fault of the existing Estate Tax Act. The exact amount of death

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[1]Seymour Fiekowsky, The Effect on Saving..., p. 229 in Shoup, ...Estate and Gift Taxes.

duty payable cannot be known until such a time as the assessment of the final, aggregate amount of the estate is received from the Department of National Revenue. If re-assessment is requested by the executor, the time needed to arrive at the exact amount of the tax can be increased significantly. The testator-to-be can never know the amount of liquidity necessary, but a reasonable estimate can be made.

A more serious contention is presented regarding the undesirable effects estate taxes have on these estates which are comprised mostly or partially of ownership in private businesses. These estates, it is claimed, would rarely have sufficient liquid assets, and consequently, at the time of death the control of the business may pass to the hands of strangers. The liquidity problem increases the more successful a business is, since there will be a large portion of the estate for which ready buyers may be scarce. The intensity of the problem will change depending on whether the firm is a proprietorship, a partnership, or a limited company.[2] The most serious problem can be encountered in the case of proprietorship. "Since liquidity within any business is almost never conducive to maximum productivity, cashable assets are minimized. In the private company, 'tight money' is accepted as a normal bridle on business activity, ..."[3] Excessive cash or other forms of liquid assets, beside decreasing the productivity of the firm, decrease the profitability as well which can increase the danger of a take-over raid by corporations suffering from deficiency of near-cash assets.[4]

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[2]Shoup, ...Estate and Gift Taxes, p. 94.

[3]Savage and Van Den Bulcke, Transfer Taxes..., p. 51.

[4]Marris, ...'Managerial' Enterprise, pp. 187-188.

The liquidity problem is rooted in the uncertainty about the length of life of the testator-to-be, the amount of estate tax payable, and in the closely connected problem with the latter, namely, the process of valuation of the ownership, or part of it, by the taxation authorities.

The difficulty based on the overestimation of life expectancy was discussed above so it will not be considered here. The question of the amount of tax liability, however, is a more complex matter.

> The rates of taxation are simple and clear, but the same is not true of the tax base to which these rates are applied.
> This brings us face-to-face with the problem of unmarketable ownership interests and how they are valued for tax purposes. The range of uncertainty here is very great for there is no single valuation formula that is applied by the tax authorities or by the courts; there isn't even any consistent method that has common recognition or acceptance.[5]

Although this was written with reference to the United States, a similar opinion was expressed in a Canadian study as well.[6] The inevitability of the tax with its implicit uncertainties causes the owner of a private business, it is claimed, to take steps to mitigate the liquidity and valuation problem. There are a number of avenues open to an individual,[7] but only the two major ones, namely, the outright sale of and merging

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[5]Chelcie C. Bosland, "Has Estate Taxation Induced Recent Mergers?", National Tax Journal, XVI, (June, 1963), p. 160.

[6]Savage and Van Den Bulcke, Transfer Taxes:..., p. 51.

[7]Harold H. Somers, "Estate Taxes and Business Mergers: The Effects of Estate Taxes on Business Structure and Practices in the United States," The Journal of Finance, XII, (May, 1958) discusses the possibilities of various stock purchase agreements, the use of insurance policies, the use of marital and charity deductions to obviate the latent problems the death of the owner of the estate will create.

the business into a larger corporation, will be considered.

> A standard criticism of the Estate Tax Act is that estate taxes are causing hardship to small businesses, and forcing sell-outs to either large corporations or foreign interests, or both. This is a serious criticism and if correct it must receive careful attention,...Elimination of small businesses through wholesale mergers into larger corporations or takeovers by foreign commerce is not,...in the national interest.[8]

Savage and Van Den Bulcke[9] cites 16 letters from principals of businesses who have stated estate taxes to be the main reason for the sale of their businesses. The authors, on this evidence, concluded that "Forced sale resulting from presssing demands of death taxation, ...bulks large as a causative factor in such sales."[10] This contention was reinforced by those submissions to the Royal Commission on Taxation which were concentrating on the effects of estate taxation.[11]

Yet, on the theoretical plane, there is no unanimity of opinion with respect to the effect of death duty on liquidity of estates. The view holds that, as estate tax rates increase, the liquidity preference of testators-to-be increases causing the unnecessary accumulation of idle funds.[12] This kind of accumulation would reduce the amount of funds available for investments, and conceivably the level of national

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[8]Studies of the Royal Commission on Taxation, Death Taxes, no. 11, by J.G. Smith, D.B. Fields and E.J. Mackles, (Ottawa: Queen's Printer, 1967), p. 18.

[9]Transfer Taxes:..., pp. 25-27.

[10]Ibid., p. 51.

[11]Ibid., p. 61-63

[12]Bloch, "Economic Objectives of...", p. 144.

income would fall. Since death duty is paid out these accumulated funds, "...in an economy in which there is danger of over-saving it (estate tax) would tend to promote stability in consumption",[13] through the government's investment activity financed by the estate duties. With respect to the estate tax induced sales of businesses, others hold that, "There is no evidence...that death duties break up businesses through the strain of finding ready cash to meet them,..."[14] Still others claim (in the sense that no evidence is presented, but the claim can still be based on empirical evidence) that there are other reasons than the existence of the tax which causes individual estates to get into liquidity problem. "The regrettable aspect of these situations is that, in large measure, they are attributable to inertia and not to tax laws as is so often assumed."[15] The inertia refers to the unwillingness of individuals to make decisions which they know will help in a more acceptable and a less troublesome distribution of wealth after the individual's death. The reasons amassed for lack of gifts inter vivos can be applied here as well.

Subsequently empirical evidence will be presented as to the degree to which estates in general are suffering from lack of liquidity at the time when death duties have to be paid.

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[13] U. K. Hicks, Public Finance, (Digswell Place, England: J. Nisbet & Co., 1961), p. 206.

[14] J. M. Keynes, "The Colwyn Report on National Debt and Taxation", The Economic Journal, XXXVII, (June, 1927), p. 199.

[15] H. O. Spindler and D. Y. Timbrell, Canadian Estate Planning, (Don Mills, Ontario: CCH Canadian Limited, 1967), p. 4. Similar conclusion was drawn from a study of the investment behaviour of wealthy people in a Midwestern American city by G. Katona and J. B. Lansing, "The Wealth of the Wealthy", The Review of Economics and Statistics, XLVI (February, 1964), p. 12.

The third class of estates, which are claimed to be illiquid in nature to a larger degree then the previously discussed cases are those which mostly consist of farms. The rising land prices increase the assessable value of farms. The liquid asset portion of the farm does not keep pace with the increase in value of the land, which can lead to difficulties at the time of duty payment. The prevention of these difficulties is harder to ameliorate since any sale between, for example, a father and a son must be made for full consideration, otherwise the Department of National Revenue may declare the transfer void, and include the 'sold' land in the father's estate. Sale for full consideration is conceptually hard to make since, as is mostly the case, the sons work on the father's farm, and are unlikely to have sufficient means to purchase the farm. If the sons are not on the farm, then it is unlikely that they are interested in the purchase, even if they would be able to make such a purchase. It is also argued that some forms of farming yield such low returns on the invested capital that liquid assets are very difficult, if not impossible, to accumulate for death duty purposes.[16] Sale of farms to corporations, however, can take place notwithstanding the above personal considerations.

Some authors agree with the argument that farmers may have more difficulties than private businesses meeting the death duties, even though these authors dissented from the general proposition that, in some cases, the viability of small businesses is at stake when they have

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[16] The Albertan, January 27, 1969 on p. 26 presented an interview with a liberal M.P., Mr. P. St. Pierre, who stated that, "...All ranches valued at more than $100,000 netted an average return of only 2.28 per cent."

have to meet the tax liability. Keynes held that, "...the troubles of landed proprietors are partly admitted."[17], and Hicks considered the death duties to be instrumental in breaking up large landed estates, because the latter was not able to generate a sufficient amount of income out of which accumulation could take place.[18] Since no study was made of the difficulties the landed estates have, the above are *a priori* arguments.

Some empirical evidence for foreign tax jurisdictions is available, and is presented hereafter.[19] Analyzing the estates administered in United States between the years 1942 and 1944 Harriss found that, "...if all debts are taken into account, total liquid assets were more than twice the tax for all estates as a group."[20] Without the consideration

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[17]Keynes, *The Colwyn Report*..., p. 199.

[18]U. Hicks, *Public Finance*, pp. 206-207. These observations were made on the U.K. farmers, so that it is not directly applicable to Canada, yet comments were not found specifically on the situation of the Canadian farmer.

[19]As far as the estates in Alberta are concerned no study is available, to the writer's knowledge at least. The only way to find out the magnitude of the liquidity problem is to calculate the amount of the liquid assets and compare this amount with the amount of duty payable. If the latter is larger than the former, then on average the estates, which are being, or were, administered, will have to dispose of some other than liquid assets to satisfy the taxes payable. Furthermore, since the estates of different size might be affected differently, a scatter of the estates must be made relative to their size, and similar comparison of liquidity vs. tax payable for the different size classes should be made. Since the files of individual estates administered in the province were not available to the writer, and since published public accounts do not contain the necessary information to perform the previously described comparisons and analyses, studies made in other jurisdictions with liquidity problem in mind, will be utilized to arrive at a conclusion.

[20]C. Lowell Harriss, "Liquidity of Estates and Death Tax Liability", *Political Science Quarterly*, LXIV (December, 1949), p. 550.

of the debts, the liquid assets were three times the amount of tax payable. The estates considered in the study were the $100,000 and above estates, so that smaller estates may have had opposite distributions of assets and would have had no effect on the findings of the study. The _per cent_ of cash, state, local government, and other bonds; and life insurance declined as the estate size increased, yet the proportion of corporation stock of total estates increased significantly. Similarly, Ilersic[21] observed that cash, life insurance proceeds and government and municipal securities declined as the size of estate increases. This study was carried out on U.K. estates in 1952-53 fiscal year. The author, considering the evidence which was published by the Inland Revenue argued that, although only eighty-six cases out of a sample of 1183 estates were found to have less liquid assets than duty liability, the preventive action taken by the rest of the testators-to-be to meet the estate duty was damaging to both the private businesses and to the economy as a whole. The basis of this argument was that private businesses are still significant in the U.K. economy.[22]

The effect of estate taxes on sale of private businesses in United States was studied by Bosland.[23] In the period 1955 to 1959, 4502 business concerns merged; out of this there were less than 3,000 private companies who have merged with the shares not listed on the stock exchange. _Ex post_ many addresses of the officers who have made

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[21]A. R. Ilersic, "Estate Duty and Private Companies", _Accounting Research_, V. (1954), p. 181.

[22]_Ibid._, p. 182.

[23]Bosland, ..._Recent Mergers_?, pp. 159-168.

the decisions were not available, so the sample was reduced to 401. The respondents were asked to rank the tax and non-tax considerations in their importance to merge. Of the 401 merged concerns, 96 considered tax inducement to be a predominant factor in their decision. These results were similar to a study performed for the mergers between 1940-1947 to which Bosland refers. He considers that, "It appears that the more moderate criticisms of estate taxation as a threat to the continuity of a number of family-owned business enterprises, ...have validity."[24] The moderate view holds that the owner(s) of private businesses are influenced by the amount of estate taxes payable, but the decision to sell the business or merge it into a large corporation is influenced by non-tax considerations as well, such as: need for investment diversification, need for management continuity when the present owner dies, the need for sharing management responsibilities. The serious criticism of estate taxes is that they cause privately owned businesses to be sold or merged into large corporations.

Up to now the analyses were considering estates with foreign jurisdictions. The detailed analysis of the Ontario estates by Cheng, Grant and Ploeger[25] for the Ontario Committee on Taxation, as will be seen, presents data which leads one to derive similar conclusions to those above.

Table 5 shows the relative importance of asset classes for different sizes of estates which were administered in Ontario and were liable for succession duty in the fiscal year 1963-1964. The analysis is based on

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[24] Ibid., p. 167.

[25] Cheng, Grant and Ploeger, Ontario Estates...,

3,983 estates filed and dutiable; the small estates, however, are grossly under-represented since, "...only 3,116 estates smaller than $100,000 in size are included, while the number of deaths of persons aged 21 or over in Ontario in 1963 was over 40,000."[26] This indicates that less than 8 per cent of people who died in that year had estates which are dutiable at all.

It can be seen from Table 5 that all types of assets, with the exception of bonds and debentures, and stocks with and without quoted prices, decline in their importance as the estate size increase. The sum of real estate, stocks without quoted prices and other property classes of assets, which can be considered to represent the illiquid portion of the estate in no category of estate size, exceeds 35.4 per cent of the total sum of estates in that given category. The most illiquid estate size class appears to be that of $900,000-999,999. Yet even in this case the liquid portion of the estates on an average, was 64.6 per cent. This data allows the conclusion that the estates under administration in 1963-64 fiscal year in Ontario, on an average, had sufficient liquid assets to cover the estate taxes without any difficulties.

The charge that estate taxes are forcing private businesses to sell out or merge was investigated by the Royal Commission on Taxation.

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[26] Ibid., p. 15.

TABLE 5

THE RELATIVE IMPORTANCE OF EACH TYPE OF ASSET FOR

VARIOUS SIZE CLASS OF ESTATES

Type of Assets	NET VALUE OF ESTATES (In $000)											
	Less Than $100	$100-199	$200-299	$300-399	$400-499	$500-599	$600-699	$700-799	$800-899	$900-999	$1000-6808	Total
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	
Real Estate	23.4%	16.5%	12.8%	13.9%	10.2%	6.4%	4.6%	6.7%	6.3%	3.2%	2.8%	15.1%
Life Insurance, Mortgage, etc.	12.2%	22.3%	16.7%	13.6%	14.3%	12.3%	1.6%	11.6%	6.8%	5.5%	6.5%	16.8%
Cash	16.8%	9.1%	8.3%	7.5%	9.1%	7.3%	9.2%	26.2%	7.1%	8.9%	7.9%	11.5%
Bonds and Debentures	18.6%	18.0%	18.0%	19.7%	12.4%	21.9%	28.4%	23.4%	24.9%	15.3%	27.1%	19.7%
Stocks with Quoted Prices	14.1%	24.8%	31.7%	30.2%	35.2%	36.2%	45.6%	20.3%	32.6%	36.2%	44.5%	26.4%
Stocks without Quoted Prices	1.5%	4.0%	6.6%	6.6%	12.4%	5.2%	0.1%	0.2%	17.7%	18.0%	9.1%	5.1%
Other Property	8.8%	8.3%	8.7%	11.2%	8.0%	13.1%	13.7%	12.5%	5.7%	14.2%	3.3%	8.5%
Debts, Liabilities	-4.4%	-3.0%	-2.8%	-2.7%	-1.6%	-2.4%	-3.2%	-0.9%	-1.1%	-1.3%	-1.2%	-3.0%

Source: Kenneth Cheng, John A.G. Grant and Henry M. Ploeger, Ontario Estates in 1963-64: A Tabular Analysis of Personal Wealth Held in Estates Out Of Which Ontario Succession Duties Were Paid, (Toronto: Queen's Printer, 1967), Table 2 on pp. 22-25.

> ...Individuals and corporations responsible for administration of estates were canvassed...and asked to submit factual evidence of cases where estate tax was the dominant factor in the sale of a small business. While a few specific instances were revealed, in many cases the fundamental reason lay somewhere else than with estate taxes. Such reasons as an offering price too attractive to resist, a lack of management capacity in the remaining family, such as a spendthrift son,... were among the most prevalent...However, it is the author's view that the Act (Estate Tax Act) does not restrict estate planning which could obviate many problems which arise on death...it is concluded that even those sales which take place prior to death are often motivated by factors extraneous to estate tax,... No suggestion (recommendation) is therefore made in this matter.[27]

Another study concluded that, "...In each instance of which we are aware, succession duties were at best a marginal consideration, not the motivating or deciding factor in the sale."[28]

The conclusion to be drawn from the above sample of empirical studies is that, on the average, estates did not face liquidity problems on the death of the testators. But,

> ...Averages conceal extremes and some of the extremes must have involved estates which were tightly pressed for cash to pay death taxes. Such cases present problems--but as individual cases, the exceptions not the rule.[29]

The motivation for sale of private business is multi-faced and only one of the facets is the estate tax consideration.

The Alberta government, by introducing the Act, wanted to decrease the tax liability on those estates whose owner fulfills the domicile or resident requirement. This expectation must be accepted to be valid, since it is the direct result of the statute.

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[27] Studies of the Royal Commission on Taxation, Death Taxes, pp. 18-20.

[28] Report of the Ontario Committee on Taxation, Lancelot J. Smith, Chairman (Toronto, Ont.: Queen's Printer, 1967, Vol. III. p. 143.

[29] Harriss, Liquidity of Estates..., p. 559.

CHAPTER VIII

THE GENERAL EFFECT OF THE ESTATE TAX REBATE ACT

In addition to the previously discussed expectations, it is the hope of the provincial government that the residents of this province will become aware 'tax-citizens' as a reaction to the introduction of the Act. The residents would be aware 'tax citizens' if they undertook to conduct their financial affairs in a manner which would minimize their tax liability. The minimization of tax liability is induced whenever the tax rates are increasing. The Act, notwithstanding the increased federal estate tax rates, reduces the tax liability on those estates which qualify for the rebate. It seems, therefore, that the Act itself decreases the need to plan the estates as carefully as was performed before. It is not to be construed that the Alberta estates are well planned, only that the Act makes the need, whatever its level, seem less urgent since the amount of rebate (i.e., 75 *per cent*, of the federally assessed tax liability which is returned to the provincial government) can be obtained by the executor before the federal tax is payable. This would help to eradicate the liquidity problem which unquestionably affects *some* estate passing in this province.

If it is assumed that in this province most testators-to-be are trying to maximize the bequeathed amounts not only by harder effort, more saving, more speculative direct investments, but by a desire to decrease the tax liability *per se*, then the expectation of the government can be fulfilled.

The Act has been in operation since April 1, 1967. This may be too short a period of time to observe any change in the amount of federal

estate tax payable on estates in this province. Over time, if taxes assessed decline as the assessed value of the estates increase, this could indicate that estates are being distributed in a manner in which tax payable is minimized. This in turn could indicate that the residents of this province have become aware 'tax-citizens'; yet even then, the enumeration and ranking of the reasons as for their significance must await an empirical study to determine the magnitude of the change induced by the existence of the Act.

CHAPTER IX

SUMMARY AND CONCLUSION

When the provincial government introduced the Estate Tax Rebate Act, there were certain reasons underpinning it and there were certain expectations attached to it. The objective of the thesis was to analyze the reasons and evaluate the expectations.

The first reason given for the introduction of the Act was that the estate taxes are a form of double taxation. The analysis showed that in order for the allegation to be true and the reason to be accepted in its unequivocal state, rather special circumstances had to be fulfilled. Since the presence of all the necessary circumstances was questioned, so was the soundness of the government's first reason for the introduction of its Act.

The second and third reasons were analyzed in conjunction with specific expectations. The amount of saving undertaken for estate creation purpose(s) by the citizens of Alberta, given the new tax condition introduced by the Act, is expected to increase. Estates assessed after April 1, 1967 receive 75 per cent of the estate tax attributable to property situated in Alberta. There are various objectives to save, yet from the point of view of this study, the interest was centered on saving for estate creation purposes. The combined reaction of the testators and heirs-to-be to the Act, and more specifically to the amount of saving, given their different predispositions as far as wealth, age, and consanguinity is concerned, was argued to be neutral with a slight bias toward declining saving propensity. The conclusion drawn from the analysis was that the expectation cannot be

accepted since, a priori, the amount saved for estate creation purposes cannot be shown to increase.

Inducement to invest into Alberta's industrial and agricultural development is expected to emanate from the introduction of the Act. It was argued that the institutionalized nature of investment makes the latter insensitive to a change in the estate tax legislation. Individual and private business investment was shown to be only a small portion of non-government investment in this province. Yet a change in the estate tax rate would most likely influence these investors. The conclusion reached was that the direct investment is not expected to increase as the result of the Act.

The second reason for the introduction of the Alberta statute was that wealthy Canadians seek a tax haven shelter before they die in jurisdictions which do not levy estate taxes. This migration not only takes accumulated wealth out of the country which can, would it remain in Canada, be invested here, but also decreases the annual tax revenue as well as the estate tax revenue on the transfer of this wealth. The extent of migration was analyzed by a study prepared for the Ontario Edonomic Council. This study found that an insignificant amount of wealth is being lost by Canada and, in particular, no evidence was found that wealthy Albertans seek no-death tax jurisdiction. Therefore, this specific reason for the introduction of the Act was rejected.

With respect to attracting wealthy individuals to this province, preliminary results are encouraging. The disadvantages of acquiring domicile in a foreign jurisdiction which offers no more than death-tax haven are not applicable to Alberta. Prefatorily, this expectation of

the government is accepted. The nature of this acceptance is based on the contention that the uniqueness and the singleness of the Act in Canada was an important element in its early success.

The third reason underlying the introduction of the Act was that estate taxes cause financial difficulties to the heirs, since liquid assets are rarely sufficient to cover the estate tax liability. Individual estates do have liquidity problems when they are transferred from one generation to another, but empirical studies analyzing all the transfers within a certain period of time, do not support this allegation. Similarly, the charge that estate taxes cause private businesses to be sold or merged into large corporations, when analyzed does not allow one to give an affirmative conclusion. There are other factors influencing a sale or a merger decision, which are as, or more important than the estate tax consideration. The general nature of the reason restricts its correctness.

The expectation that the Act will relieve the estates whose owner fulfills the domicile or residence requirement from a portion of the tax liability requires no further comment, since that is the direct result of the existence of the Act.

The last expectation tied to the introduction of the statute was that the residents of this province should become more aware 'tax-citizens'. The time period necessary to evaluate any change in the estate tax revenues assessed in this province because of better, more complete estate planning practices undertaken by the testator-to-be as a result of the new tax condition, in the writer's opinion, needs more time than the 23 months that has elapsed since the introduction of the Act. Consequently, no comment will be made with respect to this expectation.

Overall, the Act does not stand up well under the previous analyses. Only some of the expectations and reasons can be accepted within the frame of reference of this study. This leads one to conclude that the government may have had other than economic consideration in mind when it passed the Alberta Estate Tax Rebate Act.

APPENDIX I

THE CALCULATION OF AGGREGATE TAXABLE VALUE OF AN ESTATE

The estate comprises of all "property passing on death" of the deceased. This sum also includes the property owned by the deceased immediately prior to his death. Thus, the sum of the estate is calculated by including the following:

a) Gifts made by the deceased anytime prior to his death, if such a gift was made in contemplation of death and to become final only after the death of the donor.

b) Gifts made by the deceased to any person three years prior to the time of the death of the deceased.

c) Gifts made by the deceased at any time prior to his death if the donor retained any benefit from the property thus disposed, which persisted into the last three years of the donor's life.

d) Transaction in <u>inter vivos</u> settlement, under which the settler reserved any interest in the property thus settled for any period of time, or the right to reclaim the property prior to his death.

e) The beneficial interest accruing to the estate, upon death, arising out of property(ies) jointly owned by the deceased and one or more others.

f) Disposition of properties in such a manner that the amount received for the transacted property is less than the assessed value of the property at the time of disposition. Only that amount by which the assessed value is more than the consideration received is included here.

g) If property disposed by the deceased was for consideration in the form of annuity or other periodic payment for a defined time period,

the amount to be included is given by the formula defined in the Act.

h) The amount by which the value of the property to be transferred on the death of the deceased exceeds the consideration received for such property; any annuity, or other interest, any superannuation, pension, or death benefit payable after the death of the deceased is to be included.

i) The amount of life insurance which is owned by the deceased either directly or in concert with others and is payable to the deceased's wife or children, the entire policy is taxable (this also applies when the insurance policy is owned by a corporation which is controlled by the deceased). There are provisions given in the Act which define the procedures in the case of transference of life insurance policy from the deceased to others in the case when the deceased owns an accident insurance policy, in the case when the employer owns the life insurance policy, in the case when the life insurance policy is to be used to purchase annuity after the death of the deceased.

j) The property transferred in consideration of marriage within three years prior to the death of the deceased, the property in dower, or any property in which the spouse will enjoy a life tenure after the deceased's death is included in the total estate.

From the above gross estate, the following deductions are allowed, and when made, we derive the aggregate net of the estate.

a) All bona fide debts and encumbrances created by the deceased for his own benefit, provided they were outstanding immediately prior to death.

b) Reasonable funeral expenses and court fees. There are various

costs and expenses which the Act deems to be not deductible from the gross estate.

From the aggregate net value, when such a value exceeds $50,000, further deductions are allowed to derive the aggregate taxable value upon which the tax is based. These deductions are as follows:

a) Depending on the relationships between the survivors and the deceased, and independently of the survivors' individual succession, the minimum personal exemption is $40,000. The amount of deduction depends only on the existence of the survivors.

b) Gifts to charitable organizations provided that these gifts were included in the value of the gross estate.

c) Gifts made by the deceased furing his life provided that such a gift can be deemed to be part of the donor's ordinary and normal expenditure and provided that such an amount was included in the gross value of the estate.

d) War service pensions and other police and public service pensions accruing to the deceased's estate.

e) Any escheat property passing to the Crown.

Source: CCH Canadian Limited, Canadian Estate Tax and Succession Duty Guide, (Don Mills: CCH Canadian Limited, 1967) pp. 10-20.

APPENDIX 2

DEDUCTIONS ALLOWED FROM THE TAX OTHERWISE PAYABLE

From a given tax liability calculated from the aggregate taxable value, the following deductions can be made:

a) If the deceased was domiciled in British Columbia, 75 per cent of the tax applicable to the property situated in that province, furthermore if both the deceased and the successor were domiciled and resident in the Province of British Columbia, 75 per cent of the tax applicable to personal property situated outside Canada. The above 75 per cent provincial tax credit is decreased to 50 per cent in the case where the deceased was domiciled in either Ontario or Quebec.

b) The gift tax paid on any gift which has been included in the estate and not deducted from aggregate net value. This credit cannot exceed the estate tax payable in reference to the gift property.

c) The amount of estate tax, inheritance or legacy tax paid to a foreign government in reference to property situated in that foreign country. This credit cannot exceed the Canadian estate tax applicable to the foreign property.

The above deductions must be taken in the order outlined above because of the "notch" provision which allows a further deduction in that amount of estate tax which exceeds one half of the difference between $50,000 and the aggregate net value of the estate. This provision eliminates estate tax liability on all estates in close proximity of $50,000.

Source: John W. Graham, Taxation in Estate Planning, (Toronto: The Institute of Chartered Life Underwriters of Canada, 1965), pp. 36-37.

APPENDIX 3

THE ALBERTA ESTATE TAX REBATE ACT

1967

CHAPTER 18

An Act to Provide for Partial Refunds of Estate Taxes to Alberta Estates

(Assented to March 30, 1967)

WHEREAS an estate tax is payable to the Government of Canada by the estates of deceased persons based on the value of the property passing on the death; and

WHEREAS the Government of Alberta receives from the Government of Canada a share of the estate tax so payable by Alberta estates; and

WHEREAS a general benefit to the Province would be realized by returning to those Alberta estates the Government of Alberta's share of the estate tax payable:

THEREFORE, HER MAJESTY, by and with the advice and consent of the Legislative Assembly of the Province of Alberta, enacts as follows:

1. This Act may be cited as The Estate Tax Rebate Act.

2. (1) In this Act,

(a) "Administrator" means the Administrator of this Act appointed pursuant to section 15;

(b) "executor" includes an administrator and a judicial trustee appointed under The Trustee Act;

(c) "Estate Tax Act" means the Estate Tax Act (Canada) as amended from time to time.

(2) Except where the context otherwise requires, words and phrases used in this Act have the same meaning as they have under the Estate Tax Act.

3. An estate tax rebate is payable under this Act only in respect of the estate tax on the estate of a person dying on or after the first day of April, 1967,

(a) who was domiciled in Alberta at the time of his death, or

(b) who was domiciled elsewhere in Canada at the time of his death but had resided in Alberta for a total of at least 183 days

(i) in each of the three years immediately preceding his death, or

(ii) in each of such greater number of years immediately preceding his death as may be prescribed by the regulations.

4. (1) The estate tax rebate in respect of the estate tax on the estate of a deceased person to whom clause (a) of section 3 refers shall, subject to this Act, be paid by the Provincial Treasurer in an amount equal to 75 per cent of the estate tax payable that is applicable to

(a) any property situated in Alberta and passing on the death of that person, and

(b) any property (other than real property) situated outside Canada and passing on the death of that person to a person domiciled or resident in Alberta.

(2) The estate tax rebate in respect of the estate tax on the estate of a person to whom clause (b) of section 3 refers shall, subject to this Act, be paid by the Provincial Treasurer in an amount equal to 75 per cent of the estate tax payable that is applicable to any property situated in Alberta and passing on the death of that person.

(3) No amount is payable as an estate tax rebate in respect of any interest or penalty paid or payable under the Estate Tax Act.

5. The right to receive estate tax rebates is dependant upon the Government of Canada paying to the Government of Alberta under the Federal-Provincial Fiscal Arrangements Act (or any legislation substituted therefor) amounts representing a portion of the estate taxes

payable by the estates in respect of which estate tax rebates are claimed, and

(a) if the payments to the Government of Alberta cease to be made, or

(b) if the rate at which the payments are calculated is increased or decreased, or

(c) if the classes of property in respect of which the payments are made are reduced or restricted,

a similar change shall be deemed to be made in the relevant provisions of this Act.

6. (1) For the purposes of this Act

(a) the domicile of a person,

(b) the property passing on the death of a person,

(c) the valuation of property,

(d) the situs of property, and

(e) the part of the estate tax payable that is applicable to any property

shall be determined as those matters are determined for the purposes of the Estate Tax Act.

(2) Except as otherwise provided in this Act or the regulations, where a decision, finding or determination on any matter has been made under the Estate Tax Act for estate tax purposes, that decision, finding or determination is final and conclusive for all purposes in connection with estate tax rebates.

7. (1) Any estate tax rebate payable shall be paid to the executor of the estate of the deceased person in respect of whose property the estate tax is payable, except where the part of the estate tax that is applicable to any property passing on the death

(a) has been paid by a successor to the property, or

(b) is under the Estate Tax Act payable by the successor to the property by reason of it being property passing to him without coming under the control of the executor of the estate of the deceased person,

in which case any estate tax rebate payable in respect thereof may be paid to the successor to the property.

(2) The payment of an estate tax rebate in respect of any estate tax

(a) to the executor of an estate, or

(b) to a successor to property,

who appears to the Administrator to be entitled thereto discharges the Government of Alberta from any further liability for the payment of an estate tax rebate in respect of that estate tax, and any other person claiming to be entitled to that rebate, or any part thereof, shall enforce his claim against the executor or successor to whom it was paid.

8. The Provincial Treasurer may deduct from an estate tax rebate payable to

(a) the executor of an estate, or

(b) the successor to any property,

the amount of any debt due from the estate or the successor, as the case may be, to the Government of Alberta and apply the amount so deducted to the satisfaction of the debt.

9. (1) An estate tax rebate is payable in respect of an estate only upon application therefor to the Administrator made within 90 days of the date the Minister of National Revenue sends a notice of assessment of the estate tax payable in respect of that estate.

(2) An application for an estate tax rebate may be made by any person to whom the estate tax rebate may be paid under this Act.

(3) An applicant for an estate tax rebate shall provide the Administrator with such information as the Administrator requires to

determine

(a) whether an estate tax rebate is payable, and

(b) the amount of any estate tax rebate payable and to whom it is payable.

10. An estate tax rebate may not be paid before the amount of estate tax payable has been assessed or before the time allowed for objections to and appeals from the assessment has expired or, where an objection or appeal has been made, before the objection or appeal has been finally determined.

11. (1) The Administrator shall, as soon as possible after receipt of all information required by him from any applicant notify the applicant whether or not the applicant is entitled to an estate tax rebate and the amount thereof, if any.

(2) The notice shall be sent to the applicant at the address set forth in the application.

12. (1) An applicant for an estate tax rebate who is aggrieved by a decision of the Administrator affecting the right to a rebate or the amount of rebate payable may, within 90 days of the date the decision is mailed to him, appeal to the Supreme Court by originating notice of motion.

(2) Subject to section 6,

(a) on hearing the appeal, the Court may confirm, vary or reverse the decision of the Administrator on any or all of the matters in issue under this Act, and

(b) the decision of the Court or of the Appellate Division of the Supreme Court on a further appeal thereto, is final and is binding upon the Government of Alberta and all other persons.

13. (1) Where after an estate tax rebate has been paid pursuant to this Act, the amount of estate tax payable is reassessed pursuant to the Estate Tax Act,

(a) if the amount of the estate tax rebate paid on the basis of the original assessment is less than the amount payable as calculated on the basis of the reassessment, an estate tax rebate in the amount of the difference may be paid upon application therefor in accordance with this Act, or

(b) if the amount of the estate tax rebate paid on the basis of the original assessment is more than the amount payable as calculated on the basis of the reassessment, the amount of the difference is a debt due to the Government of Alberta and is recoverable by action from the estate or person who received the benefit of the overpayment.

(2) On any appeal under section 12 the Government of Alberta may cross-appeal for the recovery of any debt due it by the applicant pursuant to clause (b) of subsection (1).

14. The moneys payable by the Provincial Treasurer as estate tax rebates are a charge upon and shall be paid out of the General Revenue Fund of the Province without any further or other appropriation.

15. (1) The Provincial Treasurer is charged with the administration of this Act.

(2) Subject to The Public Service Act, 1962, there may be appointed an Administrator and such other employees as are required to carry out the administration of this Act.

16. The Provincial Treasurer may make regulations

(a) prescribing, subject to the approval of the Lieutenant Governor in Council,

(i) the number of years in which residence is required under subclause (ii) of clause (b) of section 3, and

(ii) what constitutes being resident in Alberta for the purposes of clause (b) of subsection (1) of section 4,

(b) prescribing the information to be provided by applicants for an estate tax rebate,

(c) governing the manner of verifying such information,

(d) prescribing forms to be used on applications for estate tax rebates,

(e) prescribing a tariff of fees payable with respect to processing estate tax rebates,

(f) providing for the exchange of information

(i) with the Government of Canada, including in particular the exchange of information pursuant to subsection (1) of section 56 of the Estate Tax Act, and

(ii) with the government of any other province, on matters relating to estate taxes and estate tax rebates, and

(g) respecting such other matters as he considers necessary or desirable for the administration of this Act in accordance with its intent.

17. This Act comes into force on the day upon which it is assented to.

Source: The Government of Alberta, The Estate Tax Rebate Act and Regulations with Explanatory Notes, (Edmonton: Queen's Printer, 1967), pp. 10-14.

APPENDIX 4

TABLE 1

ESTATE TAXES[1] AS A PERCENTAGE OF PROVINCIAL AND FEDERAL TAX REVENUE

FOR SELECTED YEARS 1951-67

	ALBERTA			CANADA		
Year	Estate Taxes[1]	Total Revenue	Column(2) / Column(3) X 100	Estate Taxes[1]	Total Revenue	Column(5) / Column(6) X 100
	In Thousands of Dollars			In Thousands of Dollars		
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1951	$1,839	$126,312	1.45	$33,599	$1556,876	2.11
1952	1,252	130,138	0.96	38,207	2204,046	1.75
1953	2,263	165,465	1.36	38,071	2593,960	1.42
1954	1,901	209,538	0.90	39,138	2618,041	1.45
1955	2,719	205,270	1.32	44,768	2456,965	1.83
1956	2,890	258,048	1.11	66,607	2501,938	2.66
1957	3,535	280,756	1.25	79,709	3017,243	2.64
1958	4,971	288,118	1.72	71,608	3066,201	2.33
1959	3,439	275,549	1.24	72,5[(a)]	2709,5	2.67
1960	3,972	334,816	1.18	88,4	3147,6	2.80
1961	5,029	307,854	1.63	84,9	3493,7	2.43
1962	5,024	339,495	1.47	112,3	3588,7	3.12
1963	6,665	381,070	1.74	129,1	3849,7	3.35
1964	5,232	422,031	1.23	124,5	4141,9	3.00
1965	4,680	491,140	0.95	143,7	4940,7	2.90
1966	5,785	575,695	1.00	170,0	5336,1	3.18
1967	8,650	609,177	1.41	203,6	6123,3	3.32

[1]Up to fiscal year 1960 the amounts in the table represent the succession duties payable under the federal Succession Act. From that date on the amounts are estate taxes levied under the federal Estate Tax Act.

(a) Reporting has changed and a similar change was made in the Canadian Total Revenue column as well.

Sources: Calculated from: Department of National Revenue, Taxation Statistics, (Ottawa: Queen's Printer) and Public Accounts of the Province of Alberta, (Edmonton: Queen's Printer), for years 1951-1967.

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